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Institutional Voids, Investment Purposes, and Foreign Subsidiaries of Multinational Enterprises

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ABSTRACT

This dissertation is motivated by two sets of research questions: (a) *Whether, how, and when host-country market and institutional conditions have implications for the performance of foreign subsidiaries*? And (b) *Whether, how, and when investment purposes/motives for which foreign subsidiaries are established relate to the extent to which the subsidiaries/their parents overcome the hazards of or capitalize on the opportunities from operating in locations of high institutional voids*?

The first essay examines how the decision to enter African markets relates to the exit probability of MNE subsidiaries. Using a longitudinal, paired-sample design of Japanese foreign subsidiaries operating in Africa and OECD countries, it finds that entry to Africa increases the hazard rate of subsidiaries, but that subsidiaries entering with more diverse investment purposes and greater market-seeking orientation have a better likelihood of survival. Consistent with the institutional-based theory of corporate diversification, the research findings introduce purpose diversity and market-seeking orientation as potential mechanisms to mitigate the hazards of institutional voids/instability. Also, by considering the phenomenon of within-subsidiary diversity (of purposes) and its interaction with institutional conditions, the essay advances the notion of subsidiary scope and its implications.

The second essay examines the relationship between country-level income distribution and the exit of foreign subsidiaries using longitudinal data from 6,699 Japanese market-seeking subsidiaries operating in 47 countries. It finds a strong empirical evidence of a curvilinear relationship between the nature of host-country income distribution and the probability of subsidiary exit. Whereas extreme levels of income distribution (i.e., highly egalitarian or highly dispersed) correspond to higher risk of subsidiary exit, intermediate levels of income distribution are associated with a decrease in exit probability. Further, this relationship is moderated by the level of host-country institutional development.

The third essay draws on the modified one-tier bargaining model characterizing Chinese inward FDI in developing countries to advance a theory of political connections and their implications on MNE competitive advantage in developing countries. It develops a typology of political connections based on the approach to political action (transactional and relational) and the level of

participation (individual and collective). It argues that the collective-relational approach to political connections makes for superior competitive advantage, as the collective aspect facilitates access to and mobilization of resources and the relational aspect helps build favourable legitimacy. Further, it considers relevant organizational and institutional boundary conditions. The theoretical arguments integrate perspectives from the resource-based view and resource dependence theory and provide explanation to the rising prominence of Chinese MNEs in the developing world.

On the whole, this dissertation makes contributions to a better understanding of institutional voids and their economic and strategic implications. As well, it generates useful theoretical and empirical insights regarding the investment purposes/motives of multinational enterprises operating in locations of high institutional voids.

Keywords: Entry to Africa, investment purpose, investment motives, market-seeking orientation, institutional voids, institutional instability, income distribution, subsidiary exit, purpose diversity, survival analysis, market-seeking subsidiaries, political connection, MNE-host country bargaining, political institutions, political market, resource-seeking subsidiaries resource-based view, resource dependence theory, new institutional economics, transaction cost economics (politics)

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CHAPTER ONE

INTRODUCTION

Issues of host-country contexts have remained central to international business (IB) research and scholarship. Underlying research in such areas as host-country business systems (e.g., Jackson and Deeg, 2008; Meyer and Nguyen, 2005), culture (e.g., Hofstede, 1980), and infrastructure (e.g., Hoskisson et al., 2013) is the need to understand the implications of host-country conditions for multinational enterprise (MNE) investment and subsequent management. Research on host-country contexts falls within the location literature, which draws from works across multiple disciplines including international business (IB), strategic management, and economic geography (Cantwell, 2009). The location literature in IB has specifically considered location (dis)advantages as one of the major determinants of foreign direct investment (FDI) by MNEs (e.g., Dunning, 1988). In fact, Dunning (2009) noted that location has become an increasingly vital element in determining the scope, pattern, form, and growth of MNE activity. Of the myriad location-specific factors influencing FDI, the presence (absence) of market-supporting institutions is arguably the most important and one that has received considerable scholarly attention (e.g., Chan et al., 2008; Cuervo-Cazurra and Dau, 2009; Hoskisson et al., 2013). This is even more important in developing countries where such market-supporting institutions are absent, weak, or fail to perform well (Peng et al., 2009; Zoogah et al., 2015). The concept of *institutional voids* represents this phenomenon (Mair and Marti, 2009).

Institutional voids mainly represent limitations in market entry, information access, property rights protection, and contract enforcement (Khanna and Palepu, 1997). Whereas the implications of these limitations for MNE investment, management, and strategy have been widely studied (e.g. Chan et al., 2008; Cuervo-Cazurra and Dau, 2009; Santangelo and Meyer, 2011), a closer

examination reveals two potential shortcomings. First, research on the implications of institutional voids has largely drawn on insights from the new institutional economics (NIE) which emphasizes transaction cost effects. However, research leveraging insights from industrial organization theory suggest potential for market power effects as well (Porter, 1981; Teece, Pisano, Shuen, 1997). Second, we have a limited understanding of whether and how investment motivation(purposes) interact with host-country institutional contexts to affect subsidiary strategy and performance. Research in this area is important as host-country attributes interact with firm/subsidiary attributes and how these attributes influence investment of an MNE is likely to vary with differences in motives underlying such investment (Dunning, 2001; Mesquita, 2016).

The investment motives literature holds that foreign affiliates of MNEs may be established to achieve any or a combination of the following purposes: (natural) resource-seeking, efficiency-seeking, market-seeking, and strategic asset/capability seeking (Dunning, 1998; Dunning and Lundan, 2008). Such classification suggests the need to avoid adopting an aggregated treatment of MNE foreign investments by highlighting the inherent strategic as well as structural heterogeneity among MNE affiliates (subsidiaries). Investment motives define the strategic orientation of a subsidiary and the role it is expected to play in the MNE network. For example, an efficiency-seeking subsidiary emphasizes securing the minimum cost of production by leveraging cheap labour, materials, or technology available in the host country (Dunning, 1998). As well, investment motives may have implications for the structure of the subsidiary. For instance, a resource-seeking subsidiary represents a vertically integrated extension of its parent MNE and accordingly the subsidiary's activities are likely to be synchronized with both the parent MNE and 'sister' subsidiaries (Nachum and Zaheer, 2005). A market-seeking subsidiary, on the other hand, represents a standalone unit, loosely linked to the parent MNE and its 'sister' subsidiaries (Nachum

and Zaheer, 2005). Such strategic and structural differences among these different types of subsidiaries is likely to have a bearing on how host-country conditions—such as market-supporting institutions—relate to the exit likelihood of foreign subsidiaries.

The overall thrust of this thesis, therefore, is to contribute to the location literature by advancing a better understanding of institutional voids, examining its interaction with investment motives (or purposes), and generating insights on potential implications for the MNE strategy of divesting their subsidiaries. A reverse of FDI, foreign divestment is a corporate-level strategy and an important topic in IB research. Its practical as well as theoretical importance notwithstanding, our understanding of this phenomenon is limited (Berry, 2013; McDermott, 2010). By examining how investment motives interact with host-country institutional and market contexts to affect foreign divestment, this dissertation looks to contribute to a better understanding of this phenomenon. Further, the three essays included in this dissertation contribute to the overall thrust by considering different aspects of host-country contexts (institutional and market, for example) and drawing on (and contributing to) the institutional voids literature, the NIE, foreign divestment literature, and the non-market strategy literature, among others.

This chapter proceeds with a brief review of the extant literature pertaining to institutional voids, investment motive (purpose), and foreign divestment, before briefly discussing the outline of the dissertation and discussing its theoretical as well as empirical contributions. This chapter concludes with a brief discussion of each essay in order to provide an overview of the research that constitutes the dissertation.

Institutional voids

Institutions represent humanly devised restrictions that structure interactions and associated incentive structures (North, 1991). Fundamental to proper market functioning are institutional mechanisms that promote property right protection, contract enforcement, and information and market access, among others (World Bank, 2002). The concept of institutional voids entails the absence or lack of these mechanisms. Institutional voids, therefore, are responsible for market imperfections. The dissertation leverages insights from Dunning and Rugman (1985) regarding market imperfections to submit that institutional voids can engender two different forms of market imperfections. The first, which is central to NIE, is *transaction-cost market imperfection* that constrain market exchanges and therefore limit efficiency. Such imperfections '…arise naturally, or at least are assumed to be *exogenous* to the MNE,' (Dunning and Rugman, 1985: p. 229). This type of imperfection is responsible for the economic challenges MNEs encounter in the form of the increased costs associated with obtaining information and protecting property rights, for example. The second type is *structural market imperfection,* which results from potential to close markets and thereby secure market power by leveraging firm-specific advantages, such as advanced technology (Dunning and Lundan, 2008). By discouraging competition, institutional voids promote the formation of such imperfection. Unlike transaction-cost market imperfection, structural market imperfection results from firms' actions and therefore is endogenous (Dunning and Rugman, 1985).

A more complete understanding of institutional voids and their implications, therefore, requires a better understanding of the associated transaction-cost and structural market imperfections. For MNE subsidiaries, transaction-cost market imperfections are responsible for *economizing* challenges whereas structural market imperfections present *strategizing* benefits (Getachew and

Beamish, 2017; Teece *et al.*, 1997; Williamson, 1991). The viability of MNE subsidiaries operating in locations of high institutional voids, therefore, is a function of how well they mitigate the associated economic hazards and leverage pertinent strategic benefits.

As well, much of the existing research on institutional voids and market imperfections has emphasized their role in foreign investment (or entry), with little attention being paid to their implications for foreign divestment (or exit) (Berry, 2013). McDermott (2010) noted that limited scholarly attention has been paid to foreign divestment, despite its place as an integral area of IB/global strategy, and urged scholars in the area to redress the balance and foster better understanding of the phenomenon. As well, much of the research implicitly assumes that the effect of institutional voids and market imperfections on foreign investment is independent of the motives underlying such investments (Dunning, 2009; Mesquita, 2016). However, the validity of this assumption is questionable as existing research in the area suggests that such location factors interact with investment motives to influence FDI strategy and performance (Dunning, 2009; Mesquita, 2016). In fact, Mesquita (2016) called for future research to look into how investment motives influence (or interact with) location factors to influence FDI scope and patterns. By examining how investment motives interact with host-country institutions to influence foreign divestment, this dissertation seeks to respond to calls by McDermott (2010) to better understand foreign divestment and by Mesquita (2016) to examine the effects of investment motives as they interact with location factors.

Investment Motives

In the investment motives literature, Dunning (1998) elaborated on four major motives that drive MNE investments. We consider each in turn. The *resource-seeking* motive explains FDI in search of a resource that is not available in the home country or that is cheaply available in the foreign

country. Investments in resource-endowed countries are likely to have been driven by such motivation. The *efficiency-seeking* motive is pursued by a firm looking to secure lower production costs and economies of scale/scope. The *market-seeking* motive entails efforts to serve a market in the host country or in nearby regions. It also may involve reducing the transportation cost component to ensure better price competitiveness in the host country. The *strategic asset seeking* motive involves, for example, acquiring a new technological base or useful local knowledge. A related line of research on subsidiary mandate/charter has extended our understanding of the inherent heterogeneity among subsidiaries (e.g., Birkinshaw, 1996; Birkinshaw and Hood, 1998). Building on the investment motives literature, research on subsidiary mandate/charter looks at, among other things, the performance implications of the specific purposes for which subsidiaries are established (Birkinshaw and Hood, 1998).

Dunning (1998) has also examined the heterogeneity among subsidiaries (i.e., some are resource-seeking, others market-seeking, and so forth). Combining these two streams leads to an argument that location-specific (e.g., institutional) advantages or challenges are unique to different subsidiaries depending on their investment motives. This dissertation integrates Dunning's (1998) insight on investment motives with his work on institutions (e.g., Dunning and Lundan, 2008) to better appreciate the underlying interdependence between the two and understand how they interact to influence divestment of foreign affiliates.

Foreign Divestment

Foreign divestment entails "…the sale of international subsidiaries, closure of foreign plants, and exit from foreign markets." (Soule, Swaminathan, and Tihanyi, 2014, p. 1032). Just as Dunning (1988) developed a theory of FDI, so too Boddewyn (1985) introduced a theory of foreign divestment. Extant research on foreign divestment suggests that it does not necessarily indicate

failure as it may result from a deliberate attempt by an MNE to better align itself with a changed environment, gain better efficiency through market transactions rather than hierarchical transaction, or secure a more efficient reallocation of MNE resources (e.g., Boddewyn, 1985). In fact, pertinent research in the area advocates the consideration of foreign divestment as a corporate strategy and underscores the value of considering it as being part of the internationalization process of firms (Berry, 2013; Boddewyn, 1985; McDermott, 2010).

Boddewyn (1983) developed a Dunning-like 'eclectic theory of foreign divestment' in which he argued that MNEs are likely to divest their foreign affiliates when (a) competitive advantage is no longer secured; (b) internalizing no longer provides net-benefits and that market exchange is more favourable—perhaps because market-supporting institutions have developed over time; and (c) it is no longer profitable to internalize its net competitive advantages in the particular host country. Clearly, each of these conditions are likely to be contingent on the status of host-country conditions and associated changes. Also, the investment motives underlying FDI are likely to have implications for the corporate strategy of foreign divestment.

Dissertation Overview

This dissertation is organized as a collection of integrated essays. Figure 1 presents the structure of the dissertation, detailing the theoretical foundations underpinning each essay, along with both the theoretical and phenomenological contributions that link the essays together. Collectively, the dissertation contributes to a better understanding of the structural and transaction-cost market imperfections associated with institutional voids. Whereas transaction-cost market imperfections have been central to research in institutional voids, this dissertation brings a scholarly attention also to structural market imperfection which are endogenous to firms. Likewise, it advances our understanding of the strategic and economic implications of institutional voids for foreign

divestment. Also, by integrating insights from the investment motives and subsidiary mandate/charter literatures, the dissertation contributes to a better understanding of purposes underlying foreign investment and their performance implications. Further, the dissertation has contributions to the notion of foreign divestment especially from locations characterized by high institutional voids and market imperfections. Generally, each of the three essays constituting the dissertation makes conceptual and empirical contributions both at the level of the phenomena under consideration and, at a broader level, to the location, investment motives, and foreign divestment literatures.

Essay 1 looks at foreign divestment in locations of high institutional voids and high *institutional instability*, which results from such exogenous forces as a sudden change of government (Hoskisson *et al.*, 2000; Walsh, 2015; Zoogah, Peng, and Woldu, 2015). It also examines whether and how investment purpose diversity and market-seeking orientation interact with the institutional conditions to influence divestment of foreign subsidiaries. Essay 2 considers another host-country factor (i.e., income distribution) and examines whether and how host-country income distribution relates to the probability that market-seeking subsidiaries exit from the host country. Further, this essay looks at the potential interaction between host-country income distribution and institutional development to influence foreign divestment. Essay 3 draws on the *modified one-tier bargaining model* characterizing Chinese resource-seeking FDI in developing countries to advance a theory of political connection and its implications for competitive advantage (and by extension survival) of Chinese subsidiaries in their respective host countries.

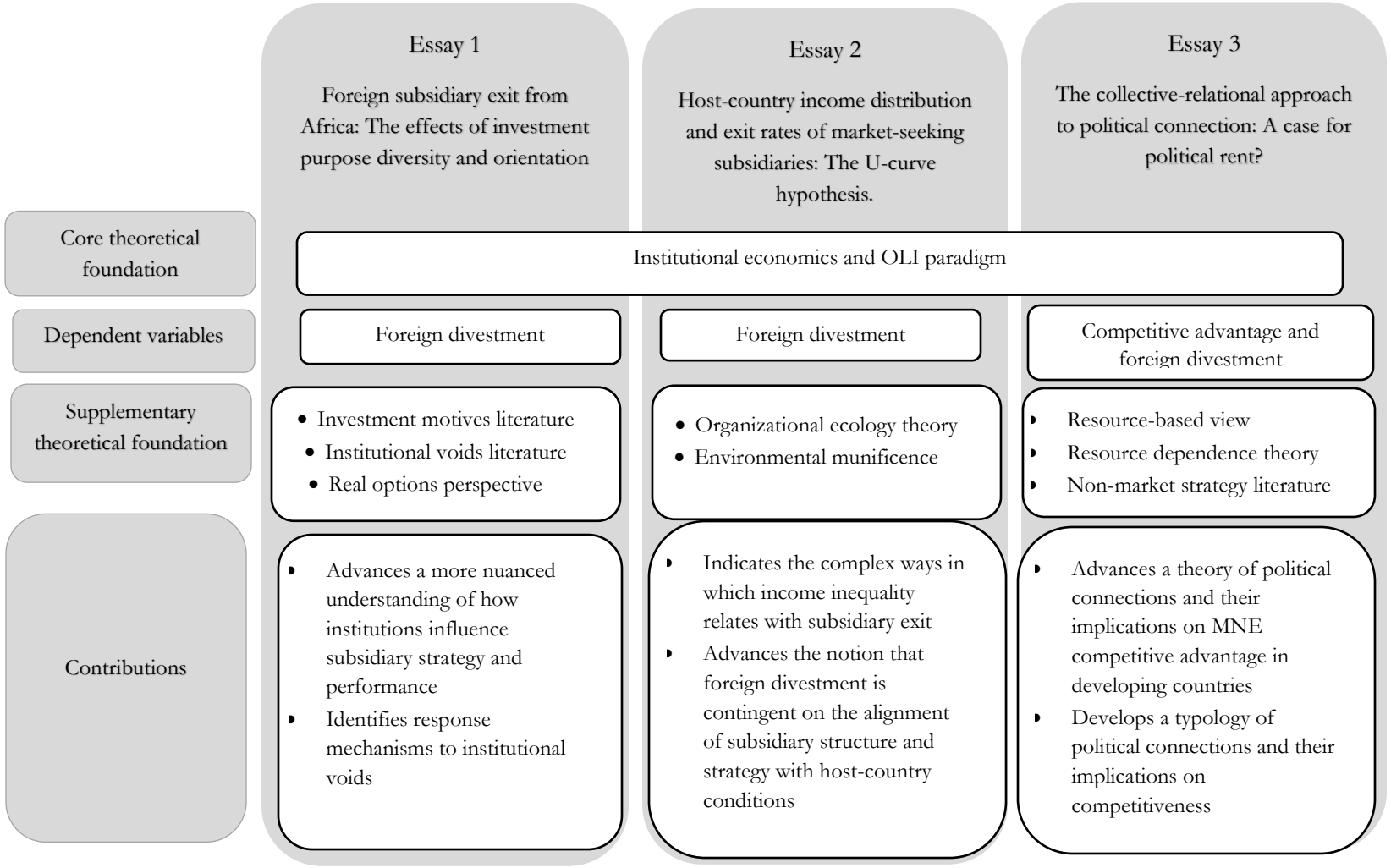

Figure 1. Overview of the Dissertation

Essay 1

The first essay (Chapter 2) is entitled *Foreign subsidiary exit from Africa: The effects of investment purpose diversity and orientation*. It examines whether and how the decision to enter African markets relates to the exit probability of MNE subsidiaries. The implications of institutional voids/instability for the strategy and performance of foreign subsidiaries is well studied (e.g., Chan, Isobe, and Makino, 2008; Cuervo-Cazurra and Dau, 2009). Consistent with North's (1991) notion of institutional economics, research in the area suggests that foreign affiliates operating in location of developed, stable market-supporting institutions are likely to register better performance and survive longer (e.g., Cuervo-Cazurra and Dau, 2009). Nonetheless, other studies have found empirical evidence in support of the alternative claim that subsidiaries operating in locations of high institutional voids/instability are more likely to register better performance than their counterparts (Chan *et al*., 2008). This essay draws on Williamson (1991) to argue that institutions have *economizing* as well as *strategizing* implications and that research in the area needs to consider both mechanisms to build a clearer understanding of how institutions relate with FDI strategy and performance.

A result of transaction-cost market imperfections, economizing suggests that subsidiaries incur greater transaction and transformation costs in location of high institutional voids/instability, thus undermining their performance. The strategizing mechanism suggests that institutional voids provide opportunities for subsidiaries to close markets and secure market power. Institutional voids limit the level of competition facing subsidiaries and make it easier for them to engage in rent-seeking behaviors to influence, for example, local and national governments. This essay argues that considering both the economizing and strategizing implications of institutions is necessary to fully understand how institutions influence subsidiary strategy (including foreign

divestment) and performance. It further argues that the dynamics and balance between these two mechanisms is context specific in that in certain contexts the economizing challenges may outweigh the strategizing benefits. Similarly, the strategic orientation of certain subsidiaries may help limit the economizing challenges and/or maximize the strategizing benefits.

This essay explores these possibilities first by considering the implications of institutional voids/instability for subsidiaries operating in the African market. It then considers subsidiary-specific attributes of *investment purpose diversity* and *market-seeking orientation* to understand whether and how such attributes influence the balance between economizing challenges and strategizing benefits, thereby influencing subsidiary exit. These arguments are tested using a longitudinal, paired-sample design of Japanese subsidiaries operating in Africa and OECD countries. The results yield support for the arguments.

This essay makes theoretical contributions on multiple respects. First, by engaging the economic and strategic implications of institutional voids/instability and considering potential boundary conditions, it advances a more nuanced understanding of how institutions influence subsidiary strategy and performance. Second, by introducing the investment purpose diversity construct, it brings to the fore the notion of *subsidiary scope.* Prior IB/strategy research has considered scope mainly at the firm level, thereby limiting our understanding of scope at the subsidiary level. Third, in considering investment motive (purposes), the essay departs from existing emphasis on the 'how' questions (e.g., entry mode research) and focus on the 'why' questions of FDI. In so doing, the essay revives attention to this important topic in IB research. Fourth, by considering the interaction between institutional voids/instability and investment motives, the essay responds to calls to better understand the interplay between location-specific advantages and firm-/subsidiary-specific attributes (Dunning, 2009; Mesquita, 2016). Fifth, the essay contributes to the institutional

voids literature by identifying investment purpose diversity and market-seeking orientations as potential mechanisms to mitigate the hazards of operating in such environments. This essay has already been published in *Global Strategy Journal*.

Essay 2

The second essay (Chapter 3) is entitled *Host-country income distribution and exit rates of market-seeking subsidiaries: The u-curve hypothesis*. It looks at the location-specific advantage of market-seeking subsidiaries and whether and how host-country income distribution is related to the exit likelihood of market-seeking subsidiaries, for which local market and networks of relationships are critical. This essay advances the notion that income distribution in the host country can influence the local market and relationships and thus the survival likelihood of market-seeking subsidiaries. Specifically, it postulates that a rise in income inequality from low levels is associated with a decrease in exit probability, but only to a point after which a rise in inequality level corresponds to a higher risk of subsidiary exit. Further, it argues that institutional development mitigates potential market/economic inefficiencies wrought by income inequality and facilitates coordination inside the subsidiary and outside in the product as well as factor markets. These predictions were tested using longitudinal data from 6699 Japanese market-seeking subsidiaries operating in 47 countries. The arguments received statistical support.

This essay has several important theoretical and empirical implications. First, it advances a more refined understanding of location-specific advantages by acknowledging that such advantages need to be understood in conjunction with the specific motives of foreign investment. That is, depending on the investment motives underlying establishment of subsidiaries, some aspects of the local context may be more relevant than others. Research regarding the organization-

environment relationship can benefit by first specifying which aspect of the environment is most relevant to the particular form of organization (Castrogiovanni, 1991). Second, by emphasizing the inherent structural and strategic differences between market-seeking subsidiaries and other forms of subsidiaries and looking at how host-country market conditions relate with foreign divestment, the essay advances the notion that foreign divestment is contingent on the alignment of subsidiary structure and strategy with host-country conditions. Third, by integrating insights from literature on environmental munificence and the new institutional economics, the essay seeks to leverage the underlying theoretical synergies and responds to calls for a joint consideration of economic and ecological perspectives (Barron, West, and Hannan, 1994; Ulrich & Barney, 1984). Fourth, by attempting to explain the exit likelihood of market-seeking subsidiaries, the essay contributes to the foreign divestment literature—which, despite being an integral element of IB research, has received only limited attention (Berry, 2013; McDermott, 2010).

Essay 3

The third essay (Chapter 4) is entitled *The collective-relational approach to political connection: A case for political rent?* It seeks to build theory regarding non-market strategy associated with foreign direct investment in developing countries. Particularly, it draws on the modified one-tier bargaining model characterizing investment of Chinese resource-seeking MNEs in developing countries (Li *et al.,* 2013) to advance a theory of political rent-seeking and its implications for foreign subsidiary competitive advantage. As with Essays 1 and 2, it considers the interplay between investment motives and host-country conditions to influence viability of foreign direct investment. In particular, it examines the potential moderating effect of investments of resource-seeking nature. This essay builds on the findings from Essay 1 regarding the implications of the strategizing mechanism for investments in locations of high institutional voids/instability to

develop a better understanding of this mechanism by considering a unique bargaining model of Chinese resource-seeking investments.

In this model, the Chinese government directly bargains strategic and operational entry deals on behalf of a consortium of Chinese companies. These companies receive financial and infrastructural supports from the Chinese government and are expected to operate in the host country. In this bargaining model the Chinese government avails development assistance to the host country in the form of low-interest loans, infrastructural development, and grants in return for the host country to provide investment opportunities and facilitate entry and local operations of the Chinese MNEs.

Building on Hillman & Hitt's (1999) arguments about the nature of political actions, Essay 3 develops a typology of political connections based on the *approach to political action* (transactional and relational) and *the level of participation* (individual and collective). Accordingly, it identifies four alternative approaches to MNE-host country bargaining: *individual-transactional*, *individual-relational*, *collective-transactional*, and *collective-relational*. By examining the natures of the bargaining models identified in related literature—namely, *one-tier bargaining*, *modified one-tier bargaining*, and *two-tier bargaining*—it matches the practical approaches with their corresponding theoretical category to build theory about their implications for competitive advantage. Also, by drawing on mechanisms from the resource-based view and resource dependence theory, it forwards propositions suggesting the relative superiority of the collective and relational approaches to political connections in securing greater competitive advantage. Competitive advantage or lack thereof is an important determinant of foreign divestment (Boddewyn, 1983). Further, propositions are presented on potential boundary conditions. This essay argues that the advantage of using the collective-relational approach to

political connection is contingent on the asset specificity of the respective investment and the development of host-country institutions (economic and political).

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CHAPTER TWO

Foreign Subsidiary Exit from Africa: The Effects of Investment Purpose Diversity and Orientation

INTRODUCTION

Emerging markets are places of striking contrasts. On one hand, they are characterized by 'institutional voids' (Santangelo and Meyer, 2011), where market-supporting institutions are absent, weak, or fail to accomplish the role expected of them (Mair and Marti, 2009) and 'institutional instability', resulting from such exogenous forces as a sudden change of government (Hoskisson *et al.*, 2000; Walsh, 2015; Zoogah, Peng, and Woldu, 2015). These institutional conditions are in large part responsible for the exceedingly high levels of uncertainty which multinational enterprises (MNEs) face when conducting business there (Dai, Eden, and Beamish, 2013; Williamson, 2000; North, 1991; Santangelo and Meyer, 2011, Xu and Meyer, 2013). Yet, with established markets fast becoming saturated, MNEs are increasingly turning to emerging markets for future growth potential. As well, the lack of institutions to foster competition in those markets means that MNE subsidiaries already operating in those markets are more likely to develop market power and thus generate supernormal profits (Chacar and Vissa, 2005; Chacar, Newburry, and Vissa, 2010; Miller and Eden, 2006).

Underlying these arguments regarding the institutional context of emerging markets are two contrasting mechanisms: *economizing* and *strategizing*. The economizing mechanism emphasizes increased transaction and transformation costs associated with performing in locations with high levels of institutional voids/instability; the strategizing mechanism, however, supports the opposite view that missing/unstable institutions act as entry barriers, which afford MNE subsidiaries already operating in those locations with greater market power and rent-seeking opportunities

(Williamson, 1991; Porter, 1981). Do the strategizing upsides more than offset the economizing downsides associated with operating in locations of high institutional voids/instability? Do the economic implications outweigh the market power benefits? Or, do the effects cancel out? Answers to these questions are likely to be context dependent and contingent on several boundary conditions. This study seeks to shed light on the issue by examining the exit implications of entry to the African context and considering the effects of relevant boundary conditions.

By emphasizing the remarkable degree of heterogeneity among emerging markets, recent research in the area calls for future research to advance a more fine-grained understanding of institutions and their performance implications (Hoskisson *et al*., 2013). Africa, for example, has distinct characteristics. Generally, the level of institutional voids is greater in Africa than in any other region in the world (Azzimonti and Sarte, 2007; Zoogah *et al*., 2015). Also, highly unstable institutional environments and discontinuous institutional transitions beset foreign investment in Africa, perhaps more so than in any other part of the world (Azzimonti and Sarte, 2007; Henisz, 2000). The combined presence in the African markets of such institutional hazards makes for a complex operating environment for foreign subsidiaries (Jackson, 2004). Whereas economizing challenges abound, so do strategizing opportunities. In other emerging markets such as China and India—countries on which existent emerging markets research disproportionately relies—institutional voids and instability are not nearly as high as in Africa and thus economizing challenges and strategizing opportunities are relatively limited (Hoskisson *et al*., 2013; Zoogah *et al.*, 2015). The African market, therefore, presents an interesting setting from which to generate fresh insights about the influences of institutional voids and dynamics on the performance of MNE subsidiaries. As well, research in a context that has largely been ignored by global strategy scholars

can promote better understanding of what Hoskisson *et al*., (2013) called the 'traditional emerging markets'.

Relatedly, the study considers relevant boundary conditions that may enable some subsidiaries operating in Africa better deal with, mitigate, or even capitalize on the lack and/or instability of institutions. Specifically, it considers two such conditions, namely subsidiary *purpose diversity* and *purpose orientation*, to understand whether/how these strategic factors can help to mitigate the hazards of institutional voids and instability. Research on investment purpose features in the investment motives literature. Dunning (1998), for example, identified four major categories of motives that underlie MNEs' foreign investment: resource seeking, market seeking, efficiency seeking, and strategic-asset seeking. This classification not only indicates the limitation in a wholesale treatment of MNEs' foreign investment but also fosters a better understanding of the inherent, strategic heterogeneity among MNE subsidiaries. A related line of research on subsidiary mandate/charter has refined this insight further (e.g., Birkinshaw, 1996; Birkinshaw and Hood, 1998). Building on the investment motives literature, research on subsidiary mandate/charter looks at, among other things, the performance implications of the specific purposes for which subsidiaries are established (Birkinshaw and Hood, 1998). It also provides theoretical arguments and empirical evidence suggesting that some subsidiaries may be responsible for a diverse group of purposes (Birkinshaw, 1996).

By integrating insights from these related streams of literature, the study examines whether purpose diversity of subsidiaries operating in Africa influence their exit likelihood. Following a similar logic from the institutional-based view of diversification, the paper argues that subsidiaries which enter Africa with diverse investment purposes are in a better position to deal with institutional challenges than their counterparts. Also, it considers whether the type of investment

purpose assigned to a subsidiary influences its ability to mitigate the effects of incomplete markets in Africa. In particular, it examines how the market-seeking orientation of a subsidiary relates to its ability to overcome institutional voids. It is argued that the unique structure (i.e., less globally integrated and more locally responsive) and strategy (i.e., substantial reliance on host country market) of such subsidiaries (Nachum and Zaheer, 2005; Slangen and Beugelsdijk, 2010) makes for better learning and adaptation useful in reducing exit probability.

These arguments were tested using a longitudinal, paired-sample design of Japanese subsidiaries operating in Africa and OECD countries. Selection bias is likely to be a major concern in trying to understand the survival implications of entry to Africa. Clearly, MNE subsidiaries operating in Africa are not randomly selected; rather, they have self-selected themselves into the African market and are more likely to have different characteristics from those investing elsewhere. As a result, the study employed an econometric strategy called *Propensity Score Matching* (PSM) to identify counterfactual cases of matching subsidiaries operating elsewhere. To achieve greater variation, it identified 'control' subsidiaries with an equal propensity of entering Africa but which actually entered the OECD group. Those subsidiaries entering Africa are considered to be the 'treatment' group. Using this strategy creates a quasi-experimental condition, thus limiting endogeneity concerns (Reeb, Sakakibara, and Mahmood, 2012).

This study is important in at least five ways. First, by engaging the economic and strategic implications of institutional voids/instability and considering potential boundary conditions, it seeks to advance a more nuanced understanding of the relationship between institutions and subsidiary exit. Also, the use of a paired-sample design with substantial between-group variation in institutional conditions makes for a greater confidence in the results. Second, it brings to the fore the notion of *subsidiary scope* and its performance implications. Prior research in global

strategy has considered scope mainly at the firm level, thereby limiting our understanding of scope at the subsidiary level. Research on the diversity/type of subsidiary purposes can address this gap. Also, considering the potential interaction between subsidiary scope and investment location can help us understand how subsidiary scope may be contingent on the institutional conditions of the host country and how, if at all, subsidiaries modify their scope to embed elements of flexibility into their structure. Third, in looking at investment purposes, it departs from existing emphasis on the 'how' questions (e.g., entry mode research) and focus on those that look at the 'why' of investing in emerging markets. Fourth, it contributes to the institutional voids literature by suggesting response mechanisms operating at the subsidiary level. It finds that subsidiaries with diverse investment purposes and greater market-seeking orientation can deal with institutional voids/instability better than their peers. Fifth, global strategy research has largely ignored Africa as a research setting, limiting our understanding of this region. This research responds to the numerous calls to help fill this gap (e.g., Jackson, 2004; Walsh, 2015; Zoogah *et al.*, 2015).

In the sections to follow, theoretical arguments leading to the research hypotheses are presented. This is followed by a brief discussion of the design employed to answer the research questions, along with the modeling procedure utilized. Next, results are presented and their implications drawn. The paper concludes by discussing contributions, highlighting limitations and identifying promising directions for future research.

THEORETICAL DEVELOPMENT

The notion of institutions and their influences on organizations has been central to emerging market research. Institutional economists consider institutions, '…humanly devised constraints that structure political, economic, and social interactions' (North, 1991: 97). Their view of

institution is as one that is created to bring order to exchanges and reduce attendant uncertainty (North, 1991). This view largely underpins our understanding of how institutions (or lack thereof) influence business strategy as well as performance. Weak and/or unstable institutions characterizing emerging markets pose economic challenges in the form of increased uncertainty and transaction costs (Khanna and Palepu, 1997; North, 1991; Williamson, 2000). Whereas research in global strategy has provided considerable support to this argument, some other research has provided contrasting evidence.

Notably, Chan, Isobe, and Makino (2008) find that subsidiaries operating in countries with less developed institutions, on average, registered better performance than their counterparts. This finding was inconsistent with their prediction, which drew on arguments from institutional economics and the institutional voids literature. A potential explanation of this finding rests in the market failure literature in strategic management that points to the strategic opportunities inherent in the weakness and/or instability of institutions (Taussig and Delios, 2015). This literature suggests that less developed institutions create market power opportunities for those firms with the required set of resources and capabilities. Therefore, a potential explanation of such contrasting finding as that in Chan *et al*. (2008) rests in the possibility that the strategic advantages of weak institutions outweigh corresponding economic challenges. A joint consideration of the economic as well as strategic implications of institutions is, therefore, key for a better understanding of institutions and their influence on firm/subsidiary performance (Nickerson, Hamilton and Wada, 2001; Williamson, 1999).

Williamson (1991) has identified two different approaches to business strategy: *economizing* and *strategizing*. Whereas the former is mainly concerned with organizational efficiency, the latter emphasizes market power advantages. Teece, Pisano, and Shuen (1997) further clarified this

classification by identifying the theoretical underpinnings of each. Economizing holds that the route to competitive advantage is through minimization of transaction and transformation costs (Teece, Pisano, and Shuen, 1997; Williamson,1991); strategizing suggests that competitive advantage results from limitations on competition and building defensible positions against competitive forces (Porter, 1981; Teece et al., 1997). Given that institutions help determine the levels of transaction/ transformation costs and market competition (North, 1990; Williamson, 2000), they are likely to have both economizing and strategizing implications.

The economizing implications arise largely from two sources: *institutional voids* and *institutional instability* (Santangelo and Meyer, 2011). Institutional voids refer to contexts "…where institutional arrangements that support markets are absent, weak, or fail to accomplish the role expected of them" (Mair and Marti, 2009: 422). Institutional voids lead to *informational problems*, inefficient judicial systems (*enforcement problems*), and misguided regulation (*competition problems*) that render host markets less efficient (Khanna and Palepu, 1997). These problems give rise to increased levels of uncertainty and transaction costs (North, 1991; Williamson, 2000). On the other hand, emerging markets are also characterized by institutional instability arising, for example, from an abrupt change of government and/or discontinuities in government policies and actions (Azzimonti and Sarte, 2007). Such changes and their consequences are usually difficult to predict and can adversely affect the capital, factor, and product markets in which MNE subsidiaries conduct their businesses (Khanna *et al.*, 2005).

Foreign subsidiaries operating in locations with institutional voids often face problems in obtaining (reliable) information about potential exchange partners. In advanced markets, such institutions as rating agencies, chambers of commerce, and other independent (third-party) organizations provide useful information about customers, distributors, and suppliers. In contrast, in emerging markets,

MNE subsidiaries have to make do without this essential input. As a result, they face much greater uncertainty and transaction costs than their counterparts operating in advanced markets (Dhanaraj and Khanna, 2011; Khanna and Palepu, 1997).

Locations with institutional voids are also fraught with enforcement problems. Even if partners have been identified and exchange contracts have been made, the issue of whether these partners will honor the transaction commitments is important. Strong contract and property rights enforcement mechanisms (e.g., sound and reliable court systems) are essential to provide incentives for honoring contracts; however, such mechanisms are largely missing in emerging markets, subjecting subsidiaries to the hazards of opportunistic behaviours and attendant inefficiencies (Williamson, 2000).

Emerging markets are also lacking in institutions useful to promote competition in product as well as factor markets. For example, entry barriers in a subsidiary's factor markets can decrease the number of suppliers available. In the product market, such barriers can limit the number of intermediaries with which a foreign subsidiary can work (Dhanaraj and Khanna, 2011; Khanna and Palepu, 1997). Such limits to competition in any of or both markets can undermine the bargaining power of the foreign subsidiaries, resulting in higher costs of operating (Porter, 1981). On the other hand, regulatory restrictions encourage rent-seeking practices by government officials—practices that may adversely affect the performance of foreign subsidiaries (World Bank, 2002).

In addition to extant institutional voids, uncertainty occasioned by the dynamic, changing nature of institutions can affect the performance of foreign subsidiaries operating in emerging markets. Instability of government regulations and other institutional elements requires foreign subsidiaries

to frequently adapt to these changes (Meyer and Peng, 2016). Also, emerging markets such as those in Africa often have a highly fragile political climate, with political conflicts arising unexpectedly and promising countries suddenly falling into disorder (Zoogah *et al.*, 2015). Since foreign subsidiaries are often considered by Africans as agents of imperialistic rule, they are highly susceptible to attacks following political crisis (Chironga *et al.*, 2011). Such attacks may range from introducing policy changes that adversely affect operations to reneging on contracts and even to the expropriation of assets.

These economizing challenges notwithstanding, weak institutions make for considerable strategizing (positioning) benefits. Two lines of arguments suggest a possible net-positive performance implication of operating in emerging markets. First, the lack of regulations promoting competition in the market where a focal subsidiary is operating can help the subsidiary secure market power and subsequently gain greater economic rent than would be possible otherwise. As well, because of their affiliation with MNEs, foreign subsidiaries are likely to have more resources with which to influence governments than local firms do and therefore can more easily (than in OECD countries) exploit institutional voids and weak governments to get an advantage[1]. This view of 'institutional voids as opportunities' is also emphasized elsewhere, albeit from a slightly different angle (Dhanaraj and Khanna, 2011; Khanna and Palepu, 1997). Also in line with this view is the argument that increased local density typical of institutionally well-developed locations heightens competitive pressures, which in turn can increase subsidiary exit (Miller and Eden, 2006).

[1] We thank an anonymous reviewer for suggesting this mechanism.

Second, literature on the performance persistence of MNE affiliates operating in emerging market (Chacar and Vissa, 2005; Chacar *et al.,* 2010) indicates that foreign subsidiaries tend to persist even in the face of poor performance because of (a) the understanding by MNE management of the relatively greater challenges of operating in emerging markets and thus a correspondingly greater allowance for substandard performance (i.e., strategic explanation); (b) the tendency for MNE managers to persevere with short-term losses and stay the course in the hope of developing experience and gradually building share, local identity, and useful political connections (Chacar and Vissa, 2005)(i.e., evolutionary/path-dependence explanation); and (c) the tendency to avoid the stigma associated with failing in emerging markets (i.e., behavioural explanation).

The potential implications of institutional voids/instability for the exit probability of foreign subsidiaries is likely to depend on the balance between associated economizing challenges and strategizing opportunities. Williamson (1991) observed that economizing is much more fundamental than strategizing and that strategizing benefits seldom prevail in the presence of significant cost burdens in production, distribution, and organization. Teece et al., (1997) echo this view by arguing that organizing effectively and efficiently to identify and embrace opportunities is more fundamental to value creation and capture than seeking market power through such actions as raising rival's costs and excluding new entrants. As well, economic rents in the strategizing (positioning) approach are monopoly rents (Teece et al., 1997), which are available only to a limited range of firms/subsidiaries and difficult to sustain in such dynamic institutional settings as those in most African countries. These arguments lead to the following hypothesis:

> ***Hypothesis 1:*** *MNE subsidiaries entering the African market face a greater likelihood of exit than their counterparts entering the OECD market (the economizing mechanism is more potent than the strategizing mechanism).*

Empirical testing of this hypothesis can only indicate which of the two countervailing mechanisms (i.e., economizing and strategizing) dominate in the context of MNE investment in Africa. Consideration of relevant boundary conditions is thus needed to gain a more refined understanding of the dynamics between these mechanisms and the corresponding implications for the exit likelihood of subsidiaries. MNE-and/or subsidiary-level strategies can help mitigate institutional hazards and/or harness market power opportunities, thus influencing subsidiary exit likelihood (Delios and Henisz, 2000; Santangelo and Meyer, 2011). Here, this study considers two such strategies: *investment purpose diversity* and *market-seeking orientation*.

Investment Purposes Diversity

Successful investments in uncertain environments require an understanding of the environment and associated dynamics (Miles and Cameron, 1982). The investment strategy to be used can reflect such understanding and preparation, or the absence thereof. One essential issue in the strategy formulation process is specifying the intended purpose(s) of the investment. Clearly, investment purposes are context dependent in that different investment locations and environments may be suitable for achieving different purposes. For instance, an environment suitable for advancing a *research and development* purpose may not be suitable for achieving a *market access* purpose. Likewise, some environments may be conducive for pursuing both purposes mentioned above, while some may not be suitable for any of the purposes.

Discussion of investment purposes has featured in prior literature on investment motives. Dunning (1998), for example, elaborated on four major motives that drive MNE investments. The *resource-seeking* motive explains FDI in search of a resource that is not available in the home country or relatively cheaper in the foreign country. Investments in resource-endowed countries are likely to

be motivated by a desire to access such resources. The *efficiency* motive is pursued by a firm looking to secure decreased production costs and scale and/or scope economies. The *market-seeking* motive entails efforts to serve a market in the host country or in nearby regions. It also may involve reducing the transportation cost component to ensure better price competitiveness in the host country. The *strategic asset seeking* motive involves acquiring a new technological base. A related line of research has extended our understanding of subsidiary heterogeneity by providing evidence suggesting that subsidiaries can have diverse purposes, possibly spanning across multiple categories (Birkinshaw and Hood, 1998).

Drawing on the investment motives literature and acknowledging that foreign subsidiaries may have diverse investment purposes can generate unique insights about subsidiary scope, its interaction with institutional environments, and its performance implications. The number and relatedness of purposes a subsidiary is expected to achieve in the host country determines its activities and thus its scope. Also, investment purposes specify the rationale for a move to a given market and define the behavior and orientation of the focal subsidiary (Nachum and Zaheer, 2005). Virtually every decision regarding the subsidiary, including one on entry mode choices, is likely to be influenced by the selected investment purpose(s) (Franco, Rentocchini, and Marzetti, 2010).

In general, adaptation and learning are essential elements of operating in such emerging markets as Africa (Luo and Peng, 1999); having diverse purposes can foster both. Thompson (2011) suggests that, under the norms of bounded rationality, firms entering environments fraught with uncertainties seek ways to buffer their technical core or infuse in their structures elements that help in adapting to changes. In the context of MNEs, having diverse purposes for a subsidiary is likely to promote possible *resource reallocation*, which refers to the reassignment over time of resources from deteriorating areas/activities to more promising ones (Adner, 2007; Klingebiel and Adner,

2015). In fact, Adner (2007) argued that existing work on flexibility has disproportionately focused on what he calls 'flexibility as a redirection of activity' (redirecting activities across subsidiaries in response to environmental changes) and suggested that future research explores 'flexibility as reassignment of resources' (shifting resources to a more favourable activity in a subsidiary). This paper considers the latter. Subsidiaries with diverse purposes have the option to abandon an investment purpose and reassign resources to more attractive others (Adner, 2007) and the value of such option is greater in emerging markets characterized by missing/unstable institutions.

Institutional voids tend to limit the flexibility of organizations operating in them (Santangelo and Meyer, 2011). As such, MNEs entering markets with high institutional voids may need to deploy mechanisms that help them secure flexibility which the environment does not provide. A simple syllogism may clarify: Flexibility is essential when operating under institutional voids (Khanna and Palepu, 1997); such environments limit flexibility (Santangelo and Meyer, 2011); therefore, it is incumbent on the firm to devise its own mechanism of flexibility. One such mechanism is having diverse investment purposes. An MNE subsidiary with diverse investment purposes can better respond to changes in, for example, government regulations as resources can readily be reconfigured to focus on a purpose least affected by the change or to revise resource allocations among the functions/activities targeted at the purposes.

Furthermore, entering emerging markets with diverse investment purposes can promote exploration, which in turn can facilitate learning about the business environment, experimenting with different activities, and understanding what works and what does not (Sorensen and Stuart, 2000). Subsidiaries having diverse investment purposes are likely to develop a better understanding of the host-country environment and build useful connections because of their potential exposure to different markets/industries and interactions with different host-country

partners (Hashai *et al*., 2010). Such exposure and connections can provide access to information useful in exploring opportunities. The global strategy literature on business groups points to a diversification premium when operating in emerging markets (Khanna and Palepu, 2000), a finding leading to the institutional-based theory of corporate diversification which posits that diversified firms overcome market imperfection prevalent in emerging markets (Khanna and Palepu, 2000; Peng et al., 2005; Wan, 2005; Wan and Hoskisson, 2003). Following similar logic, this study contends that subsidiary level diversification—in the form of purpose diversity—can help mitigate the hazards and/or expand the opportunities of conducting business in locations of high institutional voids. These, therefore, lead to the following hypothesis:

> ***Hypothesis 2***: *Investment purpose diversity negatively moderates the relationship between entry to Africa by an MNE subsidiary and its exit likelihood such that it weakens or reverses the positive relationship described by H1.*

Market-seeking Orientation

Foreign investments with greater market-seeking orientation are undertaken to serve the host-country (and at times, regional) markets through local production and distribution of goods/services, rather than exporting from the home country or other third countries (Dunning, 1998; Nachum and Zaheer, 2005). Unlike their counterparts, foreign subsidiaries with greater market-seeking orientation are more loosely coupled with their parent MNE and sister subsidiaries. They often play a more limited role in the global value-chain process than, for example, resource-seeking subsidiaries and are more locally responsive to the tastes and needs of their actual and potential customers (Slangen and Beugelsdijk, 2010). This attribute of market-seeking subsidiaries provides them with greater learning opportunities and an enhanced ability to fill institutional voids.

Out of the desire to serve local markets emerges the need for greater local embeddedness of subsidiaries with greater market-seeking orientation. Such embeddedness, in turn, enables the

subsidiary to have greater exposure to the host market and to build important ties and networks with relevant host-country stakeholders (Slangen and Beugelsdijk, 2010). As a result, the subsidiary is likely to garner relevant host-country knowledge, which may prove useful in mitigating the adverse effects of institutional voids. Likewise, the connections established and the familiarity developed can make it easier for such subsidiaries to more easily access and more successfully work with local intermediaries. Also, in response to adverse institutional conditions in the host country, MNEs may relocate their subsidiaries. However, the need for greater local embeddedness of market-seeking subsidiaries makes it difficult to exercise this option[2].

Moreover, because market-seeking subsidiaries usually act as standalone units (operationally less integrated with the parent MNE as well as sister subsidiaries), adverse conditions in the host-country institutional environment are less likely to directly affect the parent MNE and sister subsidiaries. As a result, parent MNEs are more likely to tolerate poor performance of market-seeking subsidiaries than other kinds of subsidiaries. Subsidiaries with (natural) resource-seeking orientation, for example, tend to be a part of their respective parents' supply-chain and thus have operations closely synchronized with those of the parent MNEs and 'sister' subsidiaries (Nachum and Zaheer, 2005). As a result, when adverse institutional conditions affect the focal subsidiary, the parent MNE and associated sister subsidiaries are likely to feel the effects, prompting the MNE to terminate the focal subsidiary. The foregoing arguments, therefore, lead to the following hypothesis:

Hypothesis 3: *The level of market-seeking orientation negatively moderates the relationship between entry to Africa by an MNE subsidiary and its exit likelihood such that it weakens or reverses the positive relationship described by H1.*

[2] We thank an anonymous reviewer for this suggestion.

RESEARCH DESIGN

Research Context

The last decade has seen a rapid surge in the economic development of Africa, attracting the attention of investors. In 2012, the continent registered a 5 percent increase in its FDI inflows while the global FDI inflow decreased by 18 percent (UNCTAD, 2013). A possible factor behind such a difference is the higher average rate of return for foreign investment made in the continent. In fact, the rate of FDI return is higher in Africa than in any developing region of the world (Leke *et al.*, 2010).

Despite such progress and promising prospects, the continent is still fraught with systemic challenges with performance implications for MNEs operating there (Chrysostome and Lupton, 2011). Most, if not all, of the challenges are related to the paucity of effective institutions. Also, many African countries are characterized by a high degree of political instability and a lack (or absence) of rule of law (Azzimonti and Sarte, 2007). Similarly, ineffective financial institutions and inadequate regulatory infrastructures give rise to unstable macroeconomic environments, which in turn lead to high uncertainty and greater perceived risk of investment (Asiedu, 2002).

The use of the African context was motivated by several reasons. First, by focusing on the African context, the study attempts to respond to a call for a greater focus of global strategy research on emerging economies whose institutional environments are completely different from those of developed economies, not just in their basic natures but also in the way they influence organizational behavior and performance (e.g., Hoskisson *et al.*, 2000; Khanna *et al.*, 2005; Peng *et al.*, 2008). In fact, such distinction has been made even among emerging economies in that economies such as those in Africa have considerably higher levels of institutional voids/instability and thus merit separate consideration (Hoskisson *et al*., 2013). Also, the relevance to developing

countries of conventional management theories—especially those concerned with the relationship between organizations and contexts—has been questioned (Kiggundu, Jørgensen, and Hafsi, 1983) and calls for a contextualization of international business (IB) theories have been made (e.g., Welch *et al.*, 2011). In fact, the issue of context and how it relates with MNE performance and behaviour is fundamental in IB scholarship (Shenkar, 2004; Vernon, 1994). The distinct institutional context of African countries, thus, presents an ideal setting to better understand international business and strategy in a market where institutions are weak and/or unstable.

Second, Africa's economic momentum and future growth prospects have attracted unprecedented levels of FDI activity (UNCTAD, 2013). Indications are that this trend is set to continue. Clearly, along with such increased activity and focus on the continent comes the need for a better understanding of the economic and institutional realities not just in the continent but in each country as well. Recognizing this need, the Academy of Management (AOM) launched the AOM Africa Initiative in 2011, issued a Call for Papers on management topics related to Africa, and held its first global conference in Africa in January, 2013.

Third, despite an increasing interest in research about emerging economies, high quality research in such contexts has paid very limited attention to Africa (Kolk and Lenfant, 2010; Zoogah *et al.*, 2015). Even from the limited research examining issues in the continent, a significant portion concerns issues of corporate social responsibility and most use country-level, macro indicators which provide but a telescopic view of situations on the ground. Such a shortage of empirical work about Africa is more troubling for IB whose main unit of analysis is MNEs operating across countries and regions. This study, thus, looks to address the gap and takes a modest step toward bringing more scholarly attention to Africa.

Data and Sample

To test the hypotheses, the study uses a longitudinal data of Japanese overseas investments in Africa obtained from the Toyo Keizai (TK) dataset. The dataset is based on an annual survey of general managers of Japanese overseas subsidiaries throughout the world. This dataset is ideal to test the hypotheses for several reasons. First, the longitudinal nature of the data is useful not only in increasing confidence in the results and underlying causal arguments (Bono and McNamara, 2011), but also in conducting survival analysis, which require data on multiple points. Second, it contains a fairly comprehensive data on foreign investment activities in Africa, a region largely missing from the mainstream global strategy research in part due to the lack of access to reliable data (Hoskisson *et al*., 2000). Third, Japan has been one of the major home countries for outward foreign investment throughout the world.

To achieve the empirical purpose, the study employed data on Japanese multinational subsidiaries operating in Africa. Some essential data screening and cleaning were conducted to develop a suitable dataset. Also, to ensure that the study focuses on FDIs with significant foreign investment, the study followed Beamish and Inkpen's (1998) suggestion and limited the sample to subsidiaries having at least 20 employees. Also, following Woodcock, Beamish, and Makino (1994), the study restricted the sample to those subsidiaries that were at least two years old to consider only those subsidiaries that reached an initial period of stabilization. These procedures resulted in a final sample of 126 Japanese subsidiaries operating across 28 African countries, extending over 19 years (1990‑2008), and constituting 998 subsidiary-year cases. Table 1 presents a list of these African countries along with the number of subsidiaries operating there. Data about relevant parent-level factors were obtained from the Nikkei-NEEDS dataset.

Table 1. List of African host countries and number of subsidiaries

Country	No. of Subsidiaries	Country	No. of Subsidiaries
Algeria	2	Mozambique	2
Angola	1	Niger	1
Burkina Faso	2	Nigeria	22
Cameroon	2	People's Rep. of the Congo	1
Dem. Rep. of the Congo	1	Senegal	1
Egypt	14	South Africa	34
Ethiopia	3	Sudan	1
Ghana	3	Swaziland	1
Ivory Coast	4	Tanzania	7
Kenya	5	Togo	1
Madagascar	3	Tunisia	2
Malawi	1	Uganda	3
Mali	2	Zambia	3
Mauritius	2	Zimbabwe	2

Understanding the exit implications of entry to the African market is complicated because of the inherent self-selection bias. To account for this concern, the study used a control (counterfactual) sample of comparable subsidiaries operating elsewhere. Accordingly, it identified matching subsidiaries operating in OECD countries to ensure enough variability in the characteristics of business/institutional environment between the 'treated' (i.e., African subsidiaries) and the 'control' subsidiaries (i.e., OECD subsidiaries). It employed the PSM procedure to identify matching control subsidiaries (Dehejia and Wahba, 2002). First, a comprehensive list of subsidiaries operating in 29 OECD countries is complied. Then, these subsidiaries were pooled with the treatment subsidiaries and a probit model was fitted by using subsidiary size, subsidiary age, foreign ownership ratio, the number of foreign parents, parent size, and parent R&D intensity to predict the propensity of a subsidiary to enter Africa. Using the estimated propensity score, the study identified 123 control subsidiaries matching the 126 treated subsidiaries. These 123 control subsidiaries are spread across 10 OECD countries. Three of the treated subsidiaries share matching subsidiaries with other three treated subsidiaries. These subsidiaries are retained in the final sample (per Dehejia and Wahba, 1999). The final sample includes 249 subsidiaries.

To verify the success of the matching procedure, two sets of tests were conducted. First, as reported in Table 2, t-test of means was run on the covariates used to develop the matching model. Results show no statistically significant differences between the means. Second, a probit regression was conducted using the sample of 249 matching subsidiaries to predict the probability of entering the African market. As shown in Table 2, estimates for the covariates used in the matching model are insignificant, indicating that the matching process was reasonably sound. The use of the PSM technique provides for a more randomized sample of subsidiaries with counterfactual cases, thus helping address potential endogeneity concerns (Reeb *et al*., 2012).

Table 2. Comparison of subsidiaries in Africa and OECD countries across variables using t-tests and probit regression on matching model

	t-test of means		**Matching model**	
Variables	African subsidiaries	OECD subsidiaries	β	p-value
Subsidiary age	14.71	15.11	-0.00	0.97
Subsidiary size	2.26	2.32	-0.43	0.29
Ownership ratio	43.45	44.65	-0.00	0.99
Sector dummy	2.34	2.43	-0.64	0.14
Number of foreign parents	1.38	1.40	-0.17	0.66
Parent size	4.24	4.29	0.09	0.53
Parent R&D intensity	0.02	0.05	-0.00	0.64
Purpose diversity	0.70	0.90***		
Market-seeking orientation	0.44	0.59***		
Institutional voids	45.85	25.91***		
Institutional instability	0.76	0.29***		
Years before exit	5.74	6.57***		
Constant			2.83	0.12
Number of observations			2150	
Log-likelihood			-178.39	
Wald χ^2			4.12	

*p<.05; **p<.01; ***p<.001(two-tailed)

Variables

As with any survival analysis, the dependent variable is made up of two components. The first represents the length of time in years a subsidiary takes to cease operation or to be right-censored (i.e., not cease operation within the time frame of the analysis). In the model, this is a random variable, whereas the censoring time is fixed to the year 2008. The second component is an exit indicator given by the following function.

$$\delta_i = \begin{cases} 1 \ \ if\ T_i \leq U_i \\ 0 \ \ if\ T_i > U_i \end{cases} \quad \text{...} \quad \textbf{\textit{(1)}}$$

In the above function δ_i represents the censoring result for a given subsidiary. T_i is the failure time. A subsidiary is assigned 1 if T_i is less than or equal to U_i, which is the censoring time. If otherwise, a subsidiary is said to be right-censored because there is no way to tell when that subsidiary will experience the event. In keeping with previous studies that used the same dataset, this study considers a subsidiary terminated when its records no longer appear in the dataset (e.g., Delios and Beamish, 2001). The data used in the study are published on a yearly basis, so this is the metric for specifying time.

Key Independent Variables

Entry to Africa. This variable underlies the baseline, main effect argument. Clearly, one of the most important strategic decisions of MNEs is a decision on investment locations. This decision is captured with a dichotomous variable assuming a value of ‘1’ for subsidiaries entering Africa and ‘0’ for those entering any of the OECD countries included in the sample. Here, the study makes a reasonable assumption that at the start MNEs need to confront a strategic decision of either to enter the African market or not to. Such a regional orientation of MNE location decision is

consistent with the theoretical and empirical evidence underlying the regionalization/semi-globalization literature in IB (e.g., Arregle *et al.*, 2013, Rugman and Verbeke, 2004).

To observe the differences in institutional environments of the two broad investment destinations (i.e., Africa and OECD), data on the levels of *institutional voids* and *institutional instability* were compiled. The study uses the *Heritage Foundation Index of Economic Freedom* measures to establish the level of institutional voids (Kane, Holmes, and O'Grady, 2007). The index aggregates measures on multiple aspects of economic freedom. It is a time series data providing indices from 1995 onwards. This study followed Dikova and van Witteloostuijn's (2007) approach and used the 1995 score for the years between 1990 and 1994 inclusive. The index can assume values ranging from zero to 100, higher values indicating better overall economic freedom. The values on this index were subtracted from 100 to develop the institutional voids variable so that higher values indicate greater institutional voids. Institutional instability was measured using the POLCON measure of political constraints that captures the distribution of power across the legislative, executive, and judicial branches of government to provide an estimate of how difficult it is for host government to change the rules of the game in a way that adversely affects the interest of the foreign subsidiaries (Henisz, 2000).

Investment purpose diversity. This variable was used as a moderator in the models, and it was developed out of the TK dataset using the following procedure. Related theoretical arguments suggest that having multiple purposes provides adaptability/flexibility advantage in response, for example, to unexpected policy change. Nonetheless, the degree of relatedness between or among the purposes is also important in determining the feasibility of adaptation. A concept in the real options perspective called the *subadditivity of option portfolios* holds that options which are within a given category or affected by the same environmental factors have lower value in managing

uncertainty than more diverse options (Belderbos, Tong, and Wu, 2014); that is, when one purpose is affected, the others will also be so, limiting the opportunity for the subsidiary/firm to redirect its focus and stay in operation (i.e. less ability for resource reallocation). However, a subsidiary with multiple, unrelated purposes is less likely to see all its purposes adversely affected by a policy change. As a result, in response to a policy change that makes a purpose less attractive, such subsidiary can reconfigure its resources to focus on the purpose(s) not(less) affected by the policy change.

Therefore, it is essential that the variable developed contains information about both the number of purposes a subsidiary performs as well as the degree of relation between or among those purposes. The following procedures were used to develop this variable. First, investment purposes of each subsidiary as specified by the respective general managers were identified. Next, using Dunning's (1998) classification of investment motives, the investment purposes were categorized into four categories: resource seeking, efficiency seeking, market seeking, and strategic-asset seeking. A fifth category was also included to represent other investment purposes that are not specified in the data. The investment motives and the subsidiary mandate (charter) literatures were consulted and feedback from three colleagues was obtained in classifying the purposes along the motive categories. These categories were used to decide on the relatedness of purposes. That is, purposes that fall into two different categories are considered unrelated. Table 3 presents the frequency distribution of the investment purposes and motive categories used in this study. Then the widely-used *entropy* measure was adopted to calculate purpose diversity scores for each subsidiary. The mathematical function used to calculate the *investment purpose diversity* is as follows:

$$PD=\sum_{i=1} P_i \ln(1/P_i) \ldots\ldots \textbf{\textit{(2)}}$$

In the above function, P_i is the share of attention given to the i[th] investment purpose. Here the study assumes that equal attention is given to each purpose. A useful feature of the entropy measure is its ability to capture the two essential elements of investment purpose diversity: (1) the number of investment purposes a subsidiary has; and (2) the degree of relatedness among these investment purposes (Palepu, 1985). Two subsidiaries having an equal number of investment purposes may differ in their overall investment purpose diversity score because of differences in the degree of relatedness among their respective purposes. A detailed and technical illustration of the procedure used to develop this variable is available in the Appendix.

Table 3. Frequency distribution of investment purposes and motives

		OECD subsidiaries		**African subsidiaries**	
Motive category	**Investment purpose**	**Frequency (purpose)**	**Frequency (motive)**	**Frequency (purpose)**	**Frequency (motive)**
Efficiency seeking	Labour intensity	214	768	247	824
	Tax breaks for investment	38		198	
	Building international networks of production	343		330	
	Export to Japan	138		49	
	Financing and currency hedging	35		0	
Market seeking	Market access	1078	1468	672	844
	Building international networks of distribution	216		141	
	Export to other countries	39		31	
	Building new businesses	39		0	
	Controls business of the area	18		0	
	Trade conflict	78		0	
Resource seeking	Natural resources, materials	42	42	173	173
Strategic asset seeking	Alliance with customers in Japan	70	476	2	146
	Information gathering, royalty revenue	338		126	
	Research and development	68		18	
Others	Other purposes	34	34	83	83

Market-seeking orientation. This is another moderating variable developed out of the TK dataset. First, for each subsidiary, the number of investment purposes falling into the market-seeking category was counted. Such investment purposes include market access, building new business, and building international networks of distribution. Then, this number was divided by the total number of purposes the subsidiary has to arrive at the market-seeking orientation score. The value of this variable ranges from 0 percent (indicating no market-seeking orientation) to 100 percent (indicating high market-seeking orientation).

Control Variables

To account for other potential explanations, the study controlled for several variables found at three different levels. First at the subsidiary-level, it controlled for a number of variables which have been shown to be theoretically related to subsidiary exit. It introduced subsidiary age variable to control for subsidiary age as young firms have a higher probability of exit than old ones (Carroll and Delacroix, 1982). As subsidiary size has been shown to influence exit (Moulten and Thomas, 1993), it controlled for it using the log of number of employees as its proxy. This variable is time-variant and can also proxy for many subsidiary characteristics, such as the extent of local linkages, economies of scale, and importance within intra-firm and external networks (Yang, Mudambi, Meyer, 2008). Dhanaraj and Beamish (2004) found a statistically significant relationship between foreign ownership level and subsidiary exit probability. Therefore, the study controlled for foreign ownership level by using the combined percentage of equity ownership of the foreign partners in the focal subsidiary. It also controlled for sector effect by introducing two dummy variables for three sector groups namely, primary, secondary, and tertiary.

It also included parent-level controls to account for alternative explanations of subsidiary exit arising from parent affiliation. Makino and Beamish (1998) found that the presence of multiple foreign partners increases managerial complexity, thereby influencing exit. As such, the study controlled for the number of foreign partners listed as parents of the focal subsidiary. It also controlled for parent size and used log of the combined number of employees of the parent companies as its proxy. The parent size variable is time-variant. Intangible assets of the parent is related to the exit probability of its subsidiary (Delios and Beamish, 1999) As such, the study included a parent-level research and development (R&D) intensity variable. This variable is measured as a ratio of R&D expenditure to the total sales.

To control for the effects of time and periodic crisis on the exit probability of subsidiaries, the study used the *strata* option in *stcox* estimation in STATA version 14. As a result, it specified baseline hazard of the model to each stratum of three periods namely, 1990‑1995, 1996‑2001, and 2002‑2008. By so doing, it minimized the effect of unobserved heterogeneity among periods on the exit probability of subsidiaries. The specified baseline hazard adjusts for such extraneous periodic events as the Asian financial crisis that occurred in the 1996‑2001 period in the model and that influenced investments from Asian countries, including Japan. The paper also introduced host-country fixed effects to account for unobserved heterogeneity among the countries that may explain differences in the exit probability of foreign subsidiaries.

Statistical Method

To test the hypotheses, the study employed an extended Cox regression model (Kleinbaum and Klein, 2005). It can help estimate the parameters without the need to make any assumptions about the underlying hazard distribution. The model develops a hazard function used to determine the

probability that a subsidiary experiences an event (i.e., exit), given it has survived up to time *t*. The hazard function that is denoted by $h(t, X(t))$ is as follows:

$$h(t, X(t)) = h_0(t) \exp^{[\sum_{I=1}^{P_1} \beta_i X_i + \sum_{j=1}^{P2} \sigma_i X_j(t)]} \quad \text{…….. (3)}$$

$h_o(t)$ represents the baseline hazard function that is left unspecified and reflects the underlying hazard rate when the values of all covariates $X_1, \ldots X_{p_1}$ and $X_{1(t)}, \ldots X_{p2(t)}$ equal to 0. $X(t)$ stands for the variables in the model and X_i denotes the i^{th} time-independent variable, while $X_j(t)$ the j^{th} time-dependent variable. β_i*'s* and σ_j's denote their corresponding coefficients. The extended Cox regression model accommodates the use of time-variant covariates (Kleinbaum and Klein, 2005) and produces a hazard ratio associated with each explanatory variable, along with corresponding confidence interval estimates.

RESULTS

Table 3 describes the data and provides useful statistic for subsidiaries operating in Africa and those in the OECD countries. The greater subsidiary years to subsidiary cases ratio for subsidiaries operating in OECD countries than those in African countries suggests that on average subsidiaries survive longer in the former than in the latter. This finding is also supported by the greater median number of years for the OECD subsample. The median time represents a parameter estimate for the number of years it takes for 50 percent of the subsidiaries to experience the event (i.e., exit). Relatedly, the hazard rate among African subsidiaries appears to be greater and the study used the log-rank test to examine whether there is a statistically significant difference between the exit rates between the two subsamples. The result shows a statistically significant difference in the exit rates

of subsidiaries in the two subsamples ($\chi^2 = 7.25$, $p < 0.01$), suggesting that African subsidiaries face a greater hazard rate.

Table 4. Data summary

Items	OECD subsidiaries	African subsidiaries	Total
Number of countries	10	28	38
Institutional voids(mean)	25.90	45.85	35.07[a]
Institutional instability(mean)	0.29	0.76	0.50[a]
Subsidiary years	1164	986	2150
Subsidiary cases	123	126	249
Exits	64	80	144
Median survival(years)	11	9	8[a]

[a] mean values

Table 4 presents a correlation matrix on all the variables used in the models as well as the institutional voids and instability variables. The correlations between all of the variables in the models are low and thus multicollinearity was not a concern. A collinearity diagnostic was conducted on all the variables using the variance inflation factor (VIF) method. The calculated VIF scores for all the variables are below 5, indicating that multicollinearity is not an issue. To validate the baseline assumption that the African market has a significantly different institutional environment from the OECD market, the study introduced the institutional voids and institutional instability variables. The high, positive correlation between these variables and the treatment variable is consistent with the expectation. As shown in Table 4, the African group faces significantly higher institutional voids ($t = -76.72$, $p < 0.001$) and institutional instability ($t = -53.75$, $p < 0.001$) than the OECD group.

Since the response variable is subsidiary exit and the models include a time-variant covariate, the study used the extended Cox regression to test its hypotheses. The partial likelihood procedure was employed to estimate regression parameters. The study followed the estimation procedures outlined in Singer and Willet (2003). Table 5 presents results from the tests. The analyses resulted in five models. First, the full model (i.e., Model 5), which includes all the variables and interaction

Table 5. Descriptive statistics and correlations (N = 2150)

Variables	Mean	SD		1	2	3	4	5	6	7	8	9	10	11	12	13
Subsidiary age	14.89	10.18	1													
Subsidiary size	2.28	0.61	2	0.24												
Ownership ratio	43.74	33.26	3	0.02	-0.21											
Sector dummy	2.37	0.55	4	-0.06	-0.36	0.30										
Number of foreign parents	1.39	0.61	5	0.03	0.04	0.04	-0.09									
Parent size	4.26	0.73	6	0.04	0.08	0.04	0.03	0.25								
Parent R&D intensity	0.04	0.02	7	-0.02	0.06	0.12	0.01	0.01	0.17							
Entry to Africa	0.46	0.50	8	-0.02	-0.09	-0.02	-0.13	-0.02	-0.05	-0.04						
Purpose diversity	0.81	0.68	9	-0.08	0.11	-0.00	-0.10	-0.02	0.13	-0.09	-0.15					
Market-seeking orientation	0.52	0.34	10	-0.04	-0.10	0.18	0.26	-0.02	0.06	0.01	-0.28	0.39				
Period dummies	0.93	0.81	11	0.08	-0.05	0.06	0.10	-0.04	0.07	0.04	0.13	0.09	0.08			
Institutional voids	35.05	11.68	12	0.07	-0.03	-0.07	-0.18	0.03	-0.08	-0.01	0.86	0.24	-0.14	-0.00		
Institutional instability	0.50	0.31	13	0.08	0.03	-0.18	-0.17	0.01	-0.14	-0.06	0.76	0.12	0.05	-0.07	0.80	
Survival (years)	6.17	4.19	14	0.39	0.15	-0.02	-0.09	-0.03	-0.03	0.11	-0.07	0.11	0.07	0.47	-0.03	-0.11

Correlation coefficients greater or equal to |0.05| are significant at a 5% level

Table 6. Results from the extended Cox regression model

Independent Variables	Model 5	Model 4	Model 3	Model 2	Model 1
Subsidiary age	0.009**	0.009**	0.009**	0.008**	0.008**
	(0.003)	(0.003)	(0.003)	(0.003)	(0.003)
Subsidiary size	-0.083*	-0.083*	-0.079	-0.077*	-0.079
	(0.042)	(0.042)	(0.042)	(0.042)	(0.042)
Ownership ratio	-0.003	-0.003	-0.003	-0.003	-0.003
	(0.003)	(0.003)	(0.003)	(0.003)	(0.003)
Sector- *Primary*	Reference	Reference	Reference	Reference	Reference
Secondary	0.081	-0.004	0.208	0.071	0.071
	(0.458)	(0.449)	(0.450)	(0.448)	(0.448)
Tertiary	0.900†	0.820	0.957*	0.784	0.784
	(0.488)	(0.481)	(0.484)	(0.481)	(0.481)
Number of foreign parents	-0.175	-0.169	-0.182	-0.173	-0.173
Parent size	(0.167)	(0.166)	(0.166)	(0.166)	(0.166)
	0.279	0.300†	0.255	0.276	0.271
Parent R&D intensity	(0.128)	(0.127)	(0.125)	(0.122)	(0.122)
	-0.070	-0.076	-0.074	-0.088	-0.168
	(0.120)	(0.118)	(0.120)	(0.115)	(0.107)
Country Dummies	Included	Included	Included	Included	Included
Entry to Africa	1.366**	1.103*	1.314*	0.660*	
	(0.515)	(0.432)	(0.515)	(0.322)	
Market-seeking orientation	-0.175	-0.350*	0.040		
	(0.266)	(0.174)	(0.241)		
Purpose diversity	0.177	0.264	-0.137		
	(0.235)	(0.211)	(0.169)		
Purpose diversity × Entry	-0.631*	-0.761*			
to Africa	(0.264)	(0.297)			
Market-seeking orientation	-0.292†		-0.585*		
× Entry to Africa	(0.092)		(0.281)		
Number of observations	2150	2150	2150	2150	2150
Log-likelihood	-766.063	-768.428	-769.833	-771.705	-773.374
$\chi 2$ testing model against null model	79.97***	77.24***	74.43***	102.84***	70.68***
$\chi 2$ testing model against Model 5	N/A	3.38†	4.51*	8.72***	17.20***
AIC	1477.10	1566.86	1569.66	1571.41	1575.32

†$p < .10$; *$p<.05$; **$p<.01$; ***$p<.001$(two-tailed)

Standard errors in parentheses.

Baseline hazards in all models are specific to the stratum of period that includes 1990-1995, 1996-2001, and 2002-2008.

terms, was run. Then, the significances of the interaction and main effects were examined by dropping one or more variables from the full model and comparing the log-likelihood of each nested model to that of the full model. The resulting Chi-square statistic was used to determine the

significance of the variables or interactions excluded from the full model. Model 4 excludes the interaction term between the entry to Africa variable and market-seeking orientation; whereas, Model 3 excludes the interaction term between the entry to Africa variable and purpose diversity. Model 2 excludes the interaction terms as well as the moderating variables. Model 1 further excludes the main effect. Model 1 is the most reduced model in which the treatment variable (i.e., entry to Africa) is also excluded. The corresponding Chi-square statistic resulting from comparing the log-likelihood of Model 1 and the full model indicates that the full model which includes the entry to Africa variable is superior to the reduced model ($\chi^2 = 17.20$, $p < 0.001$). A significant regression coefficient for the treatment variable in Model 5 provides support for H_1 ($\beta=1.366$, $p < 0.01$), suggesting that entry to Africa subjects Japanese subsidiaries to increased hazard. Consistent result was found from a one-tailed test deemed appropriate given the directional prediction of H_1 ($\beta=1.366$, $p < 0.01$). The *beta* coefficient corresponds to a hazard ratio of around 3.92[3], suggesting that Japanese subsidiaries that enter the African market have a 292[4] percent higher chance of exiting at time t than those that enter the OECD market. This represents the value of the effect size, suggesting the substantive significance of the finding. Figure 2 shows the estimated hazard of Japanese subsidiaries operating in OECD countries and those in African countries.

[3] The hazard ratio is calculated as e^{β}, interpreted as a percentage of change in hazard probability for 1% change in the explanatory variables. Caution need to be exercised when applying such interpretation for log-transformed variables as the changes are in log-transformed terms.

[4] The percentage is determined by subtracting 1 from the corresponding hazard ratio.

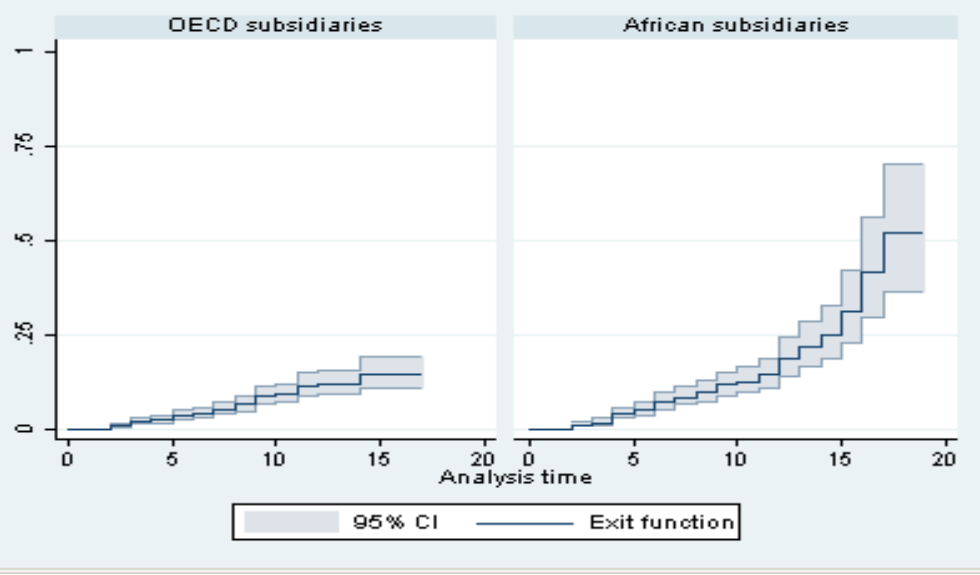

Figure 2. Estimated hazard of subsidiaries operating in the OECD countries and Africa

The second hypothesis presents a moderation effect of purpose diversity on the relationship between the strategy of entering the African market and exit probability. Model 3 provides estimates of parameters useful in testing this prediction. These findings indicate that exclusion of this interaction effect from the full model results in an inferior model, suggesting that the interaction term is a significant predictor ($\chi^2 = 4.51$, $p < 0.05$). The negative, statistically significant beta coefficient of the interaction term supports the prediction in Hypothesis 2 ($\beta = -0.631$, $p < 0.05$). This result suggests that greater purpose diversity weakens the positive relationship between entry to Africa and exit likelihood. To gain further insight into the interaction effect, the result is plotted in Figure 3. As shown in the figure, when purpose diversity is high, entry to Africa is associated with a reduced likelihood of exit. That is, Japanese subsidiaries with high purpose diversity are less likely to exit the African market than those with low purpose diversity. Also, the study follows Aiken and West (1991) to test simple slopes at high (1SD above the mean) and low (1SD below the mean) values of purpose diversity. The slopes when purpose diversity is high and

low are both significantly different from zero (β=0.512, p<0.01 and β=1.370, p<0.01, respectively), confirming the results.

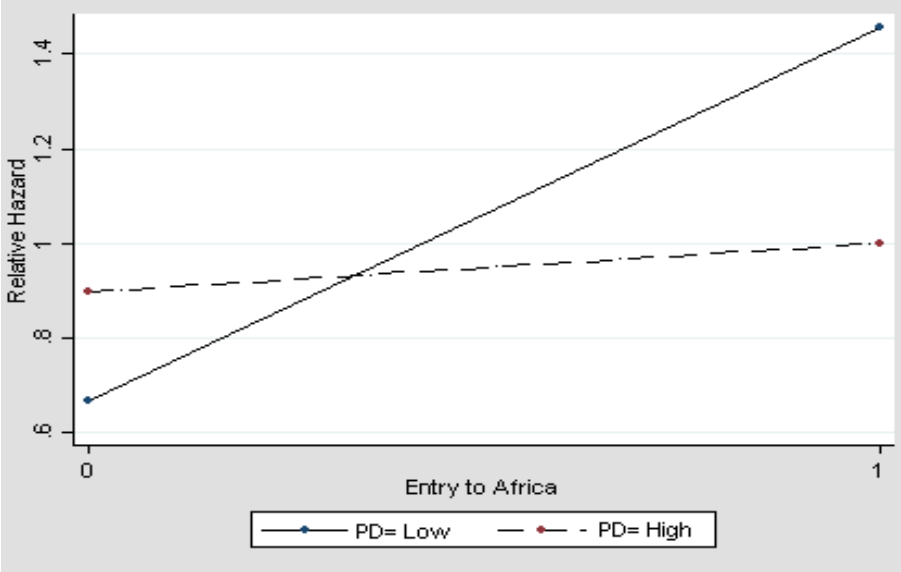

Figure 3. Moderating effects of purpose diversity

Model 4 presents results for a test of H_3, which predicts a negative moderation effect of the *market-seeking orientation* variable on the relationship between the entry of a subsidiary to Africa and its exit likelihood. In line with the expectation, comparison of log-likelihood Model 4 with that of Model 5 suggests that exclusion of the interaction term of entry to Africa and market-seeking orientation results in a Chi-square statistic that is marginally significant (χ^2 = 3.38, p < 0.1). Hypothesis 3 is marginally supported (β = -0.292, p < 0.10), such that, from Japanese subsidiaries entering the African market, those with a greater market-seeking orientation have a lower exit probability than their counterparts. Figure 4 shows this moderation effect in which high market-seeking orientation lowers the greater exit rate associated with entry to Africa. Simple slope tests were conducted at high and low levels of the market-seeking orientation variable. The effect of entry to Africa on exit likelihood is significantly different from zero for both levels (β = 1.400, p < 0.01 and β = 1.202, p < 0.05 at low and high levels respectively).

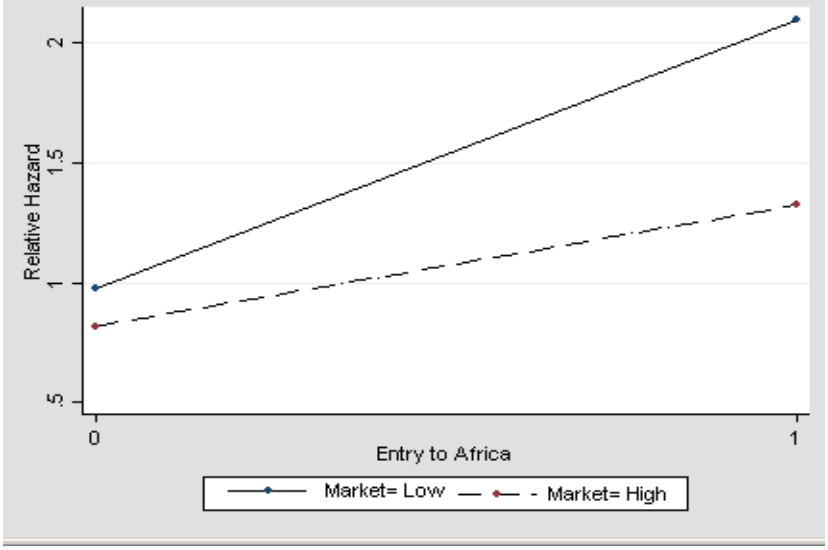

Figure 4. Moderating effects of market-seeking orientation

DISCUSSION AND CONCLUSION

Two of the three core areas in IB are MNEs and comparative national business systems (Shenkar, 2004; Vernon, 1994). MNEs exist in virtually every country in the world, where they face different national business systems. While emerging markets have been an area of growing scholarly interest (Wright *et al.*, 2005), the focus of studies on such markets has been limited to select countries and regions, with regions such as Africa largely underrepresented (Xu and Meyer, 2012). A better understanding of these regions and their institutional environments no doubt advances our appreciation of emerging markets on a number of fronts, not least of which is on how MNEs deal with associated institutional voids and the performance implications of their actions.

From the descriptive analyses, the study finds that Japanese subsidiaries entering the African market have a lower median life of nine years compared to 11 years for those entering the OECD market. While this indicates the increased hazard of subsidiaries operating in Africa, the relatively smaller than expected difference in the median years suggests that institutional challenges facing

subsidiaries operating in Africa may to a certain extent be offset by the decreased competitive pressures of operating there. Also, as expected, the levels of institutional voids and institutional instability facing subsidiaries entering the African market are significantly greater than those facing subsidiaries entering the OECD market. These two variables are central to the increased levels of uncertainty facing subsidiaries operating in Africa (Zoogah *et al.,* 2015).

Results regarding the first hypothesis provides support to the exit implications of MNEs' location decisions. It was found that, on average, the strategy of entering the African market is associated with greater exit likelihood. The paired-sample design presented counterfactual cases of Japanese foreign subsidiaries making the alternative decision (i.e., entry to the OECD market), thus providing greater confidence in building causal arguments between the location strategy and exit likelihood. The finding is consistent with several recent studies suggesting the economizing challenges of operating in Africa (Hochberg *et al.*, 2015; UNCTAD, 2015).

The findings regarding the first hypothesis generates several important insights. First, comparison of subsidiary exit probabilities across two broad, disparate groups of investment locations illustrate the effects of context on the long-term performance (or exit) of MNE subsidiaries. By doing so, the study brings attention to comparative national business systems (Shenkar, 2004; Vernon, 1994). In fact, Shenkar (2004) has urged scholars to investigate the potentially disparate influences of business environments at different investment locations. A similar call has been made to consider the contextual boundary conditions of IB theories and develop a richer understanding of the interplay between context and business performance (Welch *et al.*, 2011).

Second, the results shed some light on the economizing and strategizing implications of institutional voids/instability. Whereas investment in the OECD market benefits from the highly

developed institutional environments that reduce market imperfections and promote efficient operations (i.e., economizing benefits), it is also subjected to more intense competitive pressures as entry barriers are largely limited and market power mechanisms such as collusive behaviours are largely discouraged (i.e., strategizing challenges). In contrast, institutional voids characterizing the African environment diminish imitative and competitive pressures and make for rather easier development of market power (North, 1991). The findings suggest that, in the African market, the economizing downsides of institutional voids/instability are, on average, more potent than the associated strategizing opportunities in determining the exit probability of Japanese foreign subsidiaries. That is, in such regions as Africa, the challenges arising from the lack (absence) of market supporting institutions outweigh the benefits of decreased competitive intensity. This finding is consistent with and provides empirical evidence for the notion that economizing is more fundamental than strategizing (Teece *et al.*, 1997; Williamson, 1991).

Test of the second hypothesis provide a more nuanced understanding of the relationship between entry to Africa and exit likelihood. Results indicate that entry to Africa is related to a lower exit likelihood for subsidiaries with high purpose diversity. The theoretical arguments in support of this finding suggest that subsidiaries with diverse investment purposes can benefit from enhanced abilities of adaptability and learning, which are crucial when operating in such dynamic and institutionally less-developed locations (Jackson, 2004; Teece *et al.*, 1997). Subsidiaries with less diverse purposes are more susceptible to adverse changes in the environment (Belderbos *et al*., 2014), limiting their ability to redirect focus and remain in operation. However, for subsidiaries with more diverse purposes, it is less likely for an environmental change that affects one of the purposes to also affect the other; hence, in such a situation, these subsidiaries can remain viable by redeploying more of their resources and attention to the purpose that is not adversely hit by the

change. From a real options perspective, such advantage is termed a *flexibility option* as it fosters managerial flexibility to switch between purposes in response to new information (e.g., Chung *et al.*, 2010; Kogut and Kulatilaka, 1994; Reuer and Leiblein, 2000).

Subsidiaries that enter locations like Africa with diverse investment purposes are also in a better position to respond to or fill institutional voids. Extant research on diversity acknowledges that as well as the benefits it confers, it has several downsides. Included in the possible downsides of diversity are (a) growing strain on management to manage different purposes and deal with uncertainty along different environmental domains/markets (Grant, Jammine, and Thomas, 1988); b) increased coordination cost; and c) inefficiencies from conflicting 'dominant logics'(Markides, 1992). Diversity, therefore, makes economic sense only to the extent that its drawbacks are more than offset by its benefits (Williamson, 1985). The institutional-based view of diversity suggests that the extent to which diversity offers net-benefit is contingent on institutional factors, such that in locations where market-supporting institutions are missing, diversity offers considerable benefits (Khanna and Palepu, 1997; Peng et al., 2005; Wan, 2005; Wan and Hoskisson, 2003). The finding not only offers an additional support to the institutional-based view of diversity, but also extends our understanding by introducing the notion of within-subsidiary diversity.

By looking at the phenomenon of within-subsidiary diversity (of purposes) and its interaction with institutional conditions to affect subsidiary exit, the study advances the notion of *subsidiary scope* and its implications. Prior research in global strategy has largely focused on scope at the firm level (e.g., Peng *et al.*, 2005). Diversification has, therefore, been considered in a limited way whereby the firm operates multiple strategic business units (or subsidiaries) potentially across different industries and/or institutional environments. The subsidiary scope notion advanced here, however, responds to the need to gain better understanding of the heterogeneity of MNE subsidiaries. Some

subsidiaries discharge a broad range of responsibilities –for example, production, marketing, and central R&D for product development—whereas, others perform just a single activity (e.g., manufacturing) (Birkinshaw and Hood, 1998). This study also contributes to a better understanding of not just subsidiary scope, but its implications on foreign subsidiary exit as well.

Adner (2007) raised the notion of *flexibility as reassignment of resources*, noting that existing treatments of flexibility have largely focused on *flexibility as redirection of activity* and future research needs to look at flexibility through reallocation of resources. Similarly, treatments of flexibility in global strategy research have emphasized the flexibility advantage from shifting value-chain activities from a country experiencing adverse changes to a more favourable country within the MNE's network (Belderbos and Zou, 2007; Chung *et al.*, 2010). Whereas case studies suggest that MNEs such as GM and Qantas engage in reallocation by releasing resources from existing activities and redeploying them to new opportunities (Maitland and Sammartino, 2012), this study identifies investment purpose diversity as a potential lens through which to study such reallocations. More importantly, it identifies investment purpose diversity as a possible response to institutional voids/instability, thereby (a) bringing to the fore a response mechanism that has received less attention and (b) engaging a response that reflects the strategic decision making of MNEs when investing in emerging markets.

The result of the third hypothesis suggests that the kind of purpose a subsidiary emphasizes also matters. The study finds that when operating in institutionally weak/turbulent regions, subsidiaries with greater market-seeking orientations have a lower exit probability than their peers. It argues that the structural difference between market-seeking subsidiaries (i.e., less globally integrated and more locally responsive) and their counterpart is responsible for the differential exit rates. Being less globally integrated makes it possible for the parent MNE to tolerate adverse changes in the

host country of the focal subsidiary because such adverse change is less likely to affect the parent MNE and sister subsidiaries (Slangen and Beugelsdijk, 2010). Also, being more locally responsive facilitates the building of ties and networks with important local stakeholders, thereby fostering a better access to intermediaries and greater understanding of the host-country environment. Such access and knowledge can help market-seeking subsidiaries to more successfully operate in locations of institutional voids.

From a measurement standpoint, the use of the market-seeking orientation variable makes two important contributions. First, unlike previous research which has used proxies—such as whether a subsidiary sells to unaffiliated customers or affiliated customers (Slangen and Beugelsdijk, 2010)—to determine whether a subsidiary is market-seeking, the approach of looking at the specific investment purposes to identify market-seeking subsidiaries is not only straightforward but also likely to provide a more accurate picture. Second, the use of the term 'orientation' in the market-seeking orientation variable reflects the reality that subsidiaries may have a diverse portfolio of purposes, which can include purposes falling into more than one category. The market-seeking orientation, thus, measures the proportion of a subsidiary's purposes falling into the market-seeking category, allowing us to determine whether a subsidiary has more market-seeking orientation than another subsidiary. Results regarding investment purpose diversity and market-seeking orientation thus contribute to the global strategy literature by reemphasizing past attention to an important aspect of MNEs investments—investment purpose. The measures introduced here can inform future research in the area.

For practitioners, the empirical evidence suggests that investments in Africa have a higher probability of exit than those in OECD countries. Given the rather paradoxical anecdotal evidence and reports regarding both the merits and hazards of entering the African market, the findings

provide some clarity. The crux of the study, however, is about how subsidiaries can mitigate the hazards of operating in the African market. Accordingly, it finds that subsidiaries with diverse investment purposes are in a better position to deal with institutional voids/instability in Africa and accordingly have an even lower chance of exit than their counterparts in the OECD market. Further, subsidiaries entering the African market with a greater market-seeking orientation are more likely to develop local networks and build a better local knowledge base, thus lowering their exit likelihood.

The robustness of the findings to variations in the study sample and model specification were examined. Not all African countries have similar levels of institutional voids and institutional instability. To examine whether the results are driven by potential outliers in the sample, the models were reestimated for different sample compositions. To assess whether results might be influenced by an unusual data distribution in one or more countries, alternative paired-matches were developed. The models were rerun after five countries with the lowest and highest average values for institutional voids and institutional instability variables had been removed. While the values of the estimates did fluctuate, their signs and statistical significances remained unaltered. Models were rerun by replacing the entry to Africa variable with institutional voids and institutional instability variables. Once again, the results were consistent with the findings using the entry to Africa variable.

While it produced some useful insights, the study is not without limitations. The use of subsidiaries from only one country (i.e., Japan) may limit the generalizability of the findings to subsidiaries from other countries. In fact, the characteristics and behaviors of subsidiaries from different places, for example from developed countries and emerging countries, differs significantly (Wright *et al.*, 2005). As such, the study should be replicated using subsidiary and MNE data from other home

countries. It should be noted, however, that the use of a single home country data served an essential statistical purpose of controlling for variance arising from home-country heterogeneity. Also, the purpose diversity and market-seeking orientation variables introduced in this paper need to be further examined to verify the extent to which the measures used capture the essence of the variables. As well, this study is limited to considering only formal institutions and an interesting direction for future research is to study informal institutional voids and consider the potential dynamics between formal and informal institutional voids.

A viable extension of this work would be to look at how developments in the institutional conditions and competitive intensity across African countries influence the exit likelihood of subsidiaries and examine whether the moderating effects of investment purpose diversity and market-seeking orientation change accordingly. A growing number of African countries are continuously liberalizing their economies, with new regulations replacing the old ones (McKinsey Global Institute, 2010). Also, MNEs from advanced countries are increasingly witnessing competition arising from emerging market MNEs, including those from Africa. It would be interesting to study the comparative pace of growth in the level of competition and institutional development and accordingly identify suitable strategies for better performance and survival. Further extensions and refinements are also possible regarding the investment purpose diversity and the market-seeking orientation variables introduced in this paper. For example, as illustrated in the Appendix, the purpose diversity measure includes within-purpose diversity and between-purpose diversity. Future research needs to explore the potential contributions of each component with respect to adaptability and/or flexibility. Relatedly, future research needs to explore the extent to which diversity of purpose may help respond to or fill institutional voids. Whereas diversity can

provide flexibility advantages, too much diversity is likely to introduce complications in coordination and management (Grant, Jammine, and Thomas, 1988; Markides, 1992).

In closing, this study demonstrates that the strategy of entering the African market, on average, increases exit probability. However, subsidiaries with more diverse investment purpose and/or greater market-seeking orientation have a lower exit likelihood than their counterparts. In short, the study suggests that subsidiaries can mitigate the hazards of institutional voids/instability by having diverse investment purposes and/or greater market-seeking orientation.

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APPENDIX. PURPOSE DIVERSITY MEASURE[5]

Consider a firm having N investment purposes. The entropy measure of purpose diversity is given by the following function:

$$\text{PD}=\sum_{i=1} P_i \ln(1/P_i)$$

Where, P_i is the share of attention given to the i^{th} investment purpose. Here it was assumed that equal attention is given to each purpose. A useful feature of the entropy measure is its ability to consider both the number of the investment purposes and the degree of relatedness among them. Dunning's (1998) classification of investment motives was used to categorize the purposes. The classification includes four categories and in the data there is another category called 'others' which includes purposes which cannot clearly fall into any of the four motives. The purposes within a motive category are more related to one another than purposes across categories. The N investment purposes thus aggregate into M motive categories (see Table 3 in the paper).

Total diversification is a sum of related diversification and unrelated diversification. To calculate *related diversification* (within category diversity), two steps were followed:

1st. calculate diversity under each category.

$$\text{DRj}=\sum_{iej} Pj_i \ln(1/Pj_i)$$

Where, Pj_i is the share of a purpose in a motive category. For example, if a subsidiary has two purposes in the market-seeking category, then Pj_i will be ½.

2nd. Sum diversification scores of each segment

$$RD=\sum_{j=1}^{M} DR_j P_j$$

Where, Pj is the share of a category from the total set of categories. For example, if a subsidiary has a market-seeking motive, a resource-seeking motive, and an efficiency-seeking motive, then Pj is 1/3.

Unrelated diversification measures how subsidiary's purposes spread across diverse categories and is measured by the following:

$$DU=\sum_{j=1}^{M} P_j \ln(1/P_j)$$

So, total diversification equals the sum of RD + DU. This is the investment purpose diversity variable used in the paper.

[5] The procedures used here are adapted from Palepu (1985)

To illustrate, let us calculate diversification scores of four hypothetical cases.

Case 1 *(a subsidiary's general manager reported seven purposes spread across three motive categories)*

Resource seeking *Efficiency seeking* *Market seeking* *Strategic-asset seeking* *Other*

P1 *P2* *P3* *P4* *P5* *P6* *P7*

$DR_{(\text{resource seeking})} = \sum_{iej} Pj_i \ln(1/Pj_i) = (1/2)\ln(2) + (1/2)\ln(2) = \ln(2) = 0.69$

$DR_{(\text{Efficiency seeking})} = \sum_{iej} Pj_i \ln(1/Pj_i) = (1/3)\ln(3) + (1/3)\ln(3) + (1/3)\ln(3) = 1.0986$

$DR_{(\text{Strategic})} = \sum_{iej} Pj_i \ln(1/Pj_i) = (1/2)\ln(2) + (1/2)\ln(2) = \ln(2) = 0.69$

Therefore, RD= $RD = \sum_{j=1}^{M} DR_j P_j = 0.69(1/3) + 1.0986(1/3) + 0.69(1/3) = \underline{0.8262}$

$DU = \sum_{j=1}^{M} P_j \ln(1/P_j) = (1/3)\ln(3) + (1/3)\ln(3) + 1/3)\ln(3) = \ln(3) = \underline{1.0986}$

Total purpose diversity = RD + DU = 0.8262 + 1.0986 = **1.9248**

Case 2 *(a subsidiary's general manager reported five purposes spread across two motive categories)*

Resource seeking *Efficiency seeking* *Market seeking* *Strategic-asset seeking* *Other*

P1 *P2* *P3* *P4* *P5*

$DR_{(\text{resource seeking})} = \sum_{iej} Pj_i \ln(1/Pj_i) = (½)\ln(2) + (½)\ln(2) = \ln(2) = 0.69$

$DR_{(\text{Efficiency seeking})} = \sum_{iej} Pj_i \ln(1/Pj_i) = (1/3)\ln(3) + (1/3)\ln(3) + (1/3)\ln(3) = 1.0986$

Therefore, RD= $RD = \sum_{j=1}^{M} DR_j P_j = 0.69(1/2) + 1.0986(1/2) = \underline{0.8943}$

$DU = \sum_{j=1}^{M} P_j \ln(1/P_j) = (1/2)\ln(2) + (1/2)\ln(2) = \ln(2) = \underline{0.69}$

Total purpose diversity = RD + DU = 0.8943 + 0.69 = **1.5843**

Case 3 *(a subsidiary's general manager reported three purposes all in the same motive category)*

Resource seeking *Efficiency seeking* *Market seeking* *Strategic-asset seeking* *Other*

P3 *P4* *P5*

$DR_{(\text{Efficiency seeking})} = \sum_{iej} Pj_i \ln(1/Pj_i) = (1/3)\ln(3) + (1/3)\ln(3) + (1/3)\ln(3) = 1.0986$

Therefore, RD= $RD = \sum_{j=1}^{M} DR_j P_j = \ln(3)\,(1/1) = \underline{\underline{1.0986}}$

$DU = \sum_{j=1}^{M} P_j \ln(1/P_j) = (1/1)\ln(1) = \ln(1) = \underline{\underline{0}}$

Total purpose diversity = RD + DU = 1.0986 + 0 = **1.0986**

Case 4 *(a subsidiary's general manager reported single purpose in a single motive category)*

Resource seeking *Efficiency seeking* *Market seeking* *Strategic-asset seeking* *Other*

P4

$DR_{(\text{Efficiency seeking})} = \sum_{iej} Pj_i \ln(1/Pj_i) = (1/1)\ln(1) = \ln(1) = 0$

Therefore, RD= $RD = \sum_{j=1}^{M} DR_j P_j = 0\,(1/1) = \underline{\underline{0}}$

$DU = \sum_{j=1}^{M} P_j \ln(1/P_j) = (1/1)\ln(1) = \ln(1) = \underline{\underline{0}}$

Total purpose diversity = RD + DU = 0 + 0 = **0**

CHAPTER THREE

Host-Country Income Distribution and Exit Rates of Market-Seeking Subsidiaries: The U-Curve Hypothesis

INTRODUCTION

The issue of income inequality has captured the attention of numerous scholars and philosophers across multiple disciplines. Simon Kuznets and Joseph Stiglitz, Nobel laureates in Economics in 1971 and 2001 respectively, and many other prominent academics have studied the issue and made theoretical contributions. As well, theories of class and economic inequality have been featured in the works of influential philosophers and thought leaders such as Rousseau, Weber, Marx, and Rawls, among others. From economics to sociology and to epidemiology, different disciplines have considered societal income inequality as a relevant area of investigation. However, the organization and management fields have been largely silent on this issue (Bidwell, Briscoe, Fernandez-Mateo, and Sterling, 2013; Davis, 2015). This is curious for at least two reasons. First, increasing levels of income inequality around the world have been attributed, at least partly, to the practices and policies of organizations (Bidwell *et al*., 2013; Davis and Cobb, 2010). Second, organization and management scholars have at their disposal an 'interdisciplinary tool kit'(Bidwell *et al*., 2013) and 'an impressive set of mechanisms' (Davis, 2015) to study such socio-economic phenomena as income inequality.

Most studies of income inequality have naturally featured macro-economic issues, paying little attention to its relationship with economic organizations (See Davis and Cobb, 2010; Sorensen and Sorenson, 2007 for exceptions). Even more limited is our understanding of how income inequality relates to organizational performance. One potential approach to fill this gap is by extending arguments from existing theory on the relationship of income inequality and economic growth. Yet existing literature in the area offers conflicting suggestions. Increasing inequality

promotes market/economic efficiency (Okun, 1975; Welch, 1999), hence contributing to better organizational performance. On the other hand, increasing inequality engenders socio-economic pressures that may adversely affect performance (Bowles, 2012; Klasen, 2008). Such divergent perspectives may indicate that the relationship between income inequality and organizational performance may not be simple and that a linear specification could be misleading. This study seeks to empirically explore this possibility. Using data on Japanese market-seeking subsidiaries operating in 47 countries, the study examines the relationship between income inequality and foreign subsidiary exit. It also investigates whether this relationship is moderated by the level of host-country institutional development.

This study is important in at least three fundamental ways. First, it responds to calls for organizational and management research to look into pressing challenges facing society (e.g., Davis, 2014; Walsh, Weber, and Margolis, 2003) and examine the potential interaction between income inequality and institutional development (Lawrence *et al.*, 2015). In fact, Walsh *et al*., (2003) lamented the lack of attention to social issues in management scholarship and urged future research to rediscover the 'lost cause' of management research. Rising income inequality has increasingly become a practical concern in a number of societies. In these societies, top income earners are taking an increasingly greater share of the productivity gains and as a result the middle class that once fostered business growth is rapidly shrinking. Some consider this trend a by-product of the shareholder capitalism in which stockholders and their agents (i.e., managers) are getting the upper hand in the power struggle and thus a greater share of the residual surplus (e.g., Bidwell *et al*., 2013).

Excessive inequality is associated with wide-ranging social ills, such as reduced levels of life expectancy, social mobility, and school performance and higher degrees of anxiety, mental illness,

and high-school dropouts, among others (Wilkinson and Pickett, 2010). Perrow (1991) argued that "organizations have absorbed much of society" (p.1). As such, they too can experience the implications of the challenges facing society. This study seeks to explore this possibility. Davis (2015) emphasized the fruitfulness of such research in organization and management. Potential results can inform public policy on income inequality, institutional development, and national competitiveness.

Second, in examining the potential influence of income distribution on market-seeking subsidiaries, the study advances the notion that the effects of environmental variables can be best understood by identifying a form of organization for which such variables are more relevant. Research regarding the organization-environment relationship can benefit by first specifying which aspect of the environment is most relevant to the particular form of organization (Castrogiovanni, 1991). Market-seeking subsidiaries differ from other forms of subsidiaries in at least two fundamental ways. Structurally, they tend to operate as standalone units, loosely coupled both with other subsidiaries in their respective MNE network and with their respective parent firms (Nachum and Zaheer, 2005). As a result, a decision to terminate market-seeking subsidiaries is likely to have a relatively little, if any, effects on the operations of the MNE's network of subsidiaries. Strategically, market-seeking subsidiaries are undertaken to serve particular markets by local production and distribution, rather than by exporting from the home country or from a third country (Nachum and Zaheer, 2005; Slangen and Beugelsdijk, 2010). As such, they tend to rely heavily on host-country market and institutional conditions. Therefore, such variables as host-country income distribution and institutional development are relevant aspects of their operating environment.

The availability of a sufficient market in a host country is important, especially for market-seeking subsidiaries, in deciding to invest and continue operation there. Determining market potential in advance is difficult, and some indicators are used for the purpose. Existing literature has largely relied on Gross Domestic Product (GDP) and Per Capita Income (PCI) figures (e.g., Brouthers, Gao, and McNicol, 2008). Often, both serve as useful indicators of host-country market attractiveness. Nonetheless, they do have limitations, not least of which is their sensitivity to outliers. An increase in the income of few wealthy households in a country may increase the total (i.e., GDP) and average (i.e., PCI) national incomes and give a wrong impression that the actual income of the average households has increased over the period. Since such aggregate figures do not provide information about the sources of increased GDP, perceived market potential may be overstated. Income distribution figures, in contrast, provide information about the distribution of income, about what percentage of the income goes to what percentage of the society. Therefore, they can provide a more refined insight about demand (spending) patterns and investment potential of a market.

Third, in trying to answer the research questions, the study integrates insights from the environmental munificence literature and the new institutional economics. Such integration leverages the underlying theoretical synergies and responds to calls for a joint consideration of economic and ecological perspectives (Barron, West, and Hannan, 1994; Ulrich & Barney, 1984). Indeed, the interdisciplinary nature of the phenomenon under consideration (i.e., income inequality) demands such an approach. The study draws on insights from the literature on environmental munificence (e.g., Castrogiovanni, 1991; Dess and Beard, 1984) to develop arguments for the relationship between host-country income distribution and exit probability of market-seeking subsidiaries. Loosely integrated to the global value-chain of their respective

MNEs, market-seeking subsidiaries face more acute selection pressures arising both from their exposure to local environments and from their loose integration with parents (Bradley *et al*., 2011). In presenting arguments on how institutional development interacts with income distribution to influence subsidiary exit, the study builds on mechanisms from the new institutional economics (e.g., North, 1990; Williamson, 1981).

The following section presents a brief review of related literature, development of theoretical foundations, and discussion of arguments leading to the research hypotheses. These are followed by discussion of the research design, which specifies the research context, data and sample, empirical model, and the statistical approach used to test the hypotheses. Next, results are presented along with discussions of their implications. The study concludes by discussing theoretical and practical contributions, highlighting limitations, and suggesting directions for future research.

THEORETICAL DEVELOPMENT

Market-seeking subsidiary

Of general interest in this paper are foreign subsidiaries operating in their respective host countries. However, not all foreign subsidiaries operating in a given host country have similar resource requirements; nor are they equally (or similarly) dependent on what the host-country has to offer. As a result, clustering foreign subsidiaries into a single group can be problematic. In fact, the purpose for which subsidiaries are formed and their mandates determines the level of dependence on and interaction with their host-country environment (Dunning and Lundan, 2008). For example, subsidiaries with a (natural) resource-seeking motive tend to be a part of their respective parents' supply-chain and thus have operations closely synchronized with those of the parent MNEs and 'sister' subsidiaries (Nachum and Zaheer, 2005). To that end, the study focused only on market-

seeking foreign subsidiaries since such subsidiaries tend to operate as standalone units, with several value-chain activities located in the same host country, and depend more heavily on host-country market and institutional conditions (Slangen and Beugelsdijk, 2010).

Nachum and Zaheer (2005) identify several potential explanations for foreign market-seeking investments, all of which relate to market failure of one sort or another (Williamson, 1981). Imposition by the host government of import restrictions is one of the reasons for MNEs to establish market-seeking subsidiaries in the host country, as such restrictions make infeasible servicing a particular market via exports. Another factor behind market-seeking investments is the need to reduce transaction costs, for example those arising from transportation and associated uncertainties. Entry of market-seeking subsidiaries to their respective host country is also driven by the need for geographic proximity to the target market. Such proximity can facilitate easier (and better) access to information about the needs and wants of actual and potential customers. Viability of market-seeking subsidiaries rests, in large part, on whether the parent MNE is achieving its purposes through the subsidiary and is getting net-benefits from its investments. Generally, foreign firms are quick to adapt to unfavourable environmental aspects in the host country by terminating their subsidiaries operating there (Mata and Freitas, 2012). This is especially true of firms having market-seeking investments in the host country, as the strategic importance of such subsidiaries is decidedly linked to the host-country environment and their termination has little, if any, impact on the global MNE network (Slangen and Beugelsdijk, 2010).

International business (IB) research has identified a host of factors explaining subsidiary exit/survival. Organizing these factors by levels—namely subsidiary, firm, and country—can facilitate better understanding. Factors at the subsidiary level include ownership (level and mode) (Guar and Lu, 2007), entry mode (acquisition or greenfield) (Slangen and Hennart, 2008), level of

diversification (Li, 1995), industry relatedness to the parent (Lu and Xu, 2006), host-country experience and learning (Kim, Lu, and Rhee, 2012), and possession of intangible assets (Delios and Beamish, 2001). Included in the firm-level factors category are parent experience (Guar and Lu, 2007; Delios and Beamish, 2001), parent age and size (Lu and Xu, 2006), and sister subsidiary experience (Kim *et al*., 2012). Host-country level factors include local density and competition (Miller and Eden, 2006), level of economic development relative to home country (Tsang and Yip, 2007), and institutional development (Cuervo-Cazurra and Dau, 2009). All these factors can explain exit of market-seeking subsidiaries. Nonetheless, given that such subsidiaries are substantially different from their counterparts in terms of both structure and strategy, it is possible to find some factors that apply more to these subsidiaries than to other forms of subsidiaries (Castrogiovanni, 1991). This research argues that host-country income distribution is one such factor and seeks to examine its relationship with the exit likelihood of market-seeking subsidiaries.

The study uses the concept of environmental munificence to frame its argument on how an aspect of the host-country environment (i.e., income distribution) relates with exit likelihood of market-seeking subsidiaries. Environment munificence refers to the level of resources available and is usually measured by industry or economy growth (Dess and Beard, 1984; Castrogiovanni, 1991). The study considers host-country munificence. Host-country munificence reflects the ability of the host-country resources and markets to support sustained growth (Castrogiovanni, 1991). Less munificent host countries are characterized by shortage of resources, stagnating or declining demand, and environmental threats (Goll and Rasheed, 2005). The study argues that host-country munificence for market-seeking subsidiaries varies with the levels of income distribution. Such variation reflects the overall stock of resources and demand available for market-seeking subsidiaries operating in the host country. Host-country resources include productive inputs (e.g.,

local human, material, and capital resources), marketing resources (e.g., distribution outlets and customer base), and information resources (e.g., accurate and timely policy-related information) (Luo, 2003). The level of resource munificence (or scarcity) corresponding to different levels of income distribution can determine the survival and growth of market-seeking subsidiaries in the host country (Wan and Hoskisson, 2003).

The decision mechanism involving termination of market-seeking subsidiaries is different from that of other types of subsidiaries. Natural (resource)-seeking subsidiaries, for example, represent a vertically integrated extension of the parent firm and consequently exit decisions of such subsidiaries has to consider not just the host-country performance of the focal subsidiary but the role it plays in the global supply chain of the parent firm as well (Brouthers *et al.* 2008). As a result, a firm may decide against terminating such subsidiaries even if they register a sub-par performance in their host-country operations. Such complications are not likely to feature in the exit decisions of market-seeking subsidiaries. That is, because of their limited, if any, integration with the global supply-chain of the firm, their exit decisions is likely to be based on their present performance/future prospects (Nachum and Zaheer, 2005). Further, unlike other types of subsidiaries, market-seeking subsidiaries tend to locate several value-chain activities in the host country (Nachum and Zaheer, 2005; Slangen and Beugelsdijk, 2010). These peculiar properties of market-seeking subsidiaries suggest the importance of considering host-country munificence. Ultimately, the decision to terminate market-seeking subsidiaries is likely to be contingent on their host-country performance, which in turn depends on host-country munificence.

Through the process of making available or withholding resources, environments influence organizations (Aldrich, 1979). The relationship between the host-country environment and market-seeking subsidiaries, therefore, can be couched as the interface between the subsidiaries and

sources of host-country resources. Given that market-seeking subsidiaries tend to target market opportunities in the host country and perform several value-chain activities there, their long-term performance depends on resource provisions from the ecosystem of suppliers, partners, distributors, consumers (Pierce, 2009). These entities largely determine the level of host-country munificence. High munificence environments allow management to pursue opportunities and perform activities that will enhance the firm's value (Brauer and Wiersema, 2012). In contrast, low munificent environments limit management's ability to pursue additional value-generating opportunities. In such environments termination of a subsidiary is considered a viable strategic alternative as the firm might want to redirect its resources and capabilities to locations/subsidiaries with greater potential (Brauer and Wiersema, 2012). In fact, such behavior is indicative of the selection pressure subsidiaries face at the corporate level and is consistent with the argument that in such multi-level entities as MNEs, Darwinian selection processes at the unit (subsidiary) level may lead to adaptions at the corporate (MNE) level (Usher and Evans, 1996).

Income distribution and subsidiary exit

A limited amount of research has attempted to examine the relationship between national income distribution and organizations. Sociologists, for example, have documented how inequality in a society is accounted for by differences and changes in compensation across organizations (for a review, see Carroll and Hannan, 2000). Sorensen and Sorenson (2007) examined the link between corporate demography (i.e., the number and variety of organizations operating in a region) and income inequality. They found that increases in the number of firms within industries correspond to higher income inequality within the society; whereas, increases in the number of industries within a given economy decreases inequality levels. Likewise, Davis and Cobb (2010) argued that changes in the relative size of the largest organizations in an economy corresponds to changes in

income inequality. They noted that economies with a higher proportion of the labour force employed by large organizations face lower levels of income inequality.

Informative though these studies are, they sought to explain income inequality. These studies investigated how the nature and configuration of organizations influence the distribution of income. Given that social issues are central to research in sociology, the emphasis on income distribution as a dependent variable is justified. The intended contribution is, however, to the organization and management field in general and to IB/strategy in particular. As such, the study emphasizes organizational performance and examine if and how it is related to host-country income distribution. To better understand this relationship, the following conscious decisions were made: (a) at a conceptual level, the study looks at market-seeking subsidiaries as they target local demand for which host-country income distribution is a more relevant environmental variable and (b) at an empirical level, the study considers a long-term performance measure (i.e., exit) as it is less likely to have the effect of income inequality reflected in short-term performance measures (You and Khagram, 2005).

To establish arguments about the relationship between income inequality and subsidiary exit, the study draws on prior studies regarding the relationship between income inequality and economic growth. The decision to draw on this stream of literature is appropriate given that host-country market potential, often proxied by economic growth (e.g., Brouthers *et al.* 2008), is a relevant consideration for market-seeking subsidiaries. A number of studies documented the relationship between income inequality and economic growth (e.g., Easterly, 2007; Okun, 1975). Research in the area offers conflicting perspectives, however. For example, an IMF study reports that greater income inequality is strongly associated with shorter spells of economic growth (Berg *et al.*, 2014). The study finds that a 50 percent decrease in the inequality levels of some of the most unequal

nations could lead to a 200 percent longer duration of economic growth. In contrast, others argue that inequality is vital for a given economy and forms the basic foundations on which strong economies lie. Okun (1975), for example, noted that more efficiency comes at the expense of greater inequality. Welch (1999) wrote along the same lines: "It is not much of an exaggeration to say that all of economics results from inequality. Without inequality…there would be no trade, no specialization, and no surplus…." (p.2).

The presence of divergent perspectives about the relationship between inequality and economic performance may be indicative of a non-linear model specification. In fact, Banerjee and Duflo (2003) examined data used to study the relationship and found that linear structures were wrongly imposed on the data. This finding helped explain, in part, the mixed results regarding the relationship between inequality and economic growth. Similarly, Hasanov and Izraeli (2011), using a longitudinal data of 48 U.S. states, found a non-linear relationship between inequality and economic growth showing that a rise from a lower level to an average level of income inequality increases growth, while any increase in inequality above the average level decreases growth.

Integrating insights gleaned from these studies with the notion of environmental munificence discussed earlier, this study argues that income distribution has a non-monotonic relationship with the exit probability of foreign subsidiaries. That is, highly egalitarian and highly dispersed income distribution are associated with decreased levels of host-country munificence in the form of resources and demand, thus increasing the exit probability of market-seeking subsidiaries. In contrast, intermediate levels of income distribution correspond to greater host-country munificence and thus lower likelihood of exit for market-seeking subsidiaries. Hence, the study argues that income distribution is transitively associated with foreign subsidiary exit through its influences on environmental munificence. Below, the nature of the proposed relationship is

examined in fair detail by considering host-country munificence associated with shifts to and away from two extreme states of income distribution.

Highly egalitarian income distribution

An increase in income inequality from a low level can release resources and expand the munificence of the host-country environment. To elaborate this argument, consistent with Hannan, Carroll, & Polos (2003), the study identified three relevant aspects inherent to the environment in which market-seeking subsidiaries conduct their business: customers (demand), access to qualified and motivated labour force, and availability of related (or supporting) local businesses. An increase in income inequality from a very low level can broaden the potential market available for the foreign subsidiaries. Economic historians have documented how a growing middle class ushered in a period of remarkable business and economic growth (Adelman & Morris, 1967; Landes, 1998). The introduction of industrial society and the development of financial structures led to increasing income inequality (Barro, 2000). These increases were largely due to increased economic productivity, which allocated an increased share of wealth to the middle class. This in turn created a strong and stable demand for products and services provided by companies, thereby creating a virtuous cycle (Landes, 1998).

With an increased allocation of wealth to the middle class comes a greater perceived incentive for education and training (Bapuji, 2015). This can boost both public and individual investments in education, resulting in an increased supply (i.e., both quantity and quality) of labour for subsidiaries. The incentive for developing skills and knowledge also influences labour markets inside each subsidiary and across the population. As well, motivation of and competition among workers in both the internal and external labour markets can contribute positively to subsidiary and population performance. Friedman (1962) argued that inequality encourages people to have

higher aspirations and work harder, thereby increasing productivity. Also, research indicates that the success of innovative activities vitally relies on location-bound factors, such as labour market conditions (Porter, 2011).

Another important component in the host country of market-seeking subsidiaries is the availability of local industries and firms to support the foreign subsidiary population. Since market-seeking subsidiaries tend to perform several functions—including procurement, production, and marketing—in the host country, the presence of related industries and organizations is crucial. Delgado, Porter, & Stern (2010) argued that a presence of strong clusters (i.e., a large presence of related industries) is associated with the growth and survival of start-up firms. Lippmann, Davis, and Aldrich (2005) identified two types of entrepreneurship activities in a host country: opportunity-driven and necessity-driven. Local ventures established to support a population of foreign subsidiaries seek to take advantage of the special needs of the population and thus are likely to be opportunity-driven. They found an inverted-U shape relationship between economic inequalities and the formation and growth of opportunity-driven businesses in that the relationship is positive at lower levels of income distribution. This finding is consistent with the argument that highly egalitarian income distribution limits the incentives to saving and investment (e.g., Bowles, 2012) and suggests that as inequality increases from low levels, the formation and growth of related industries is likely to increase. This in turn can expand the resource base (or factor pool) for market-seeking subsidiaries, thus decreasing their exit likelihood.

Highly dispersed income distribution

A rise in income inequality after a threshold level can influence the aggregate demand available to a population of market-seeking subsidiaries. As more income increasingly gets into the hands of the few, a greater majority of the society will have a smaller share of the total income of the country

and thus will have a lower ability to consume (You and Khagram, 2005). The propensity to consume concept suggests that high income people have a higher tendency of saving, thus a lower propensity of consumption, than low income people (Stiglitz, 2009). If host-country consumption is lacking, MNEs will see little reason to support their market-seeking subsidiary operating there. This is especially true given that MNEs' internal capital market seeks to efficiently allocate capital across the available network of investments, thus posing a greater selection pressure on the market-seeking subsidiaries with sub-par prospects (Bradley *et al*., 2011; Williamson, 1981). Hence, as host-country income inequality becomes excessively high, so does the probability of relocating MNE resources away from the subsidiary operating there, thus increasing its exit likelihood.

Lippmann et al. (2005) finding of an inverted-U shape relationship between income inequality and the formation and growth of opportunity-driven businesses suggests that after a certain level, any increase in income inequality leads to a lower number and growth of opportunity-driven local businesses. A reduction in the number of local business to support the population of foreign subsidiaries represents a contraction in the munificence of the host country (Castrogiovanni, 1991). Such contraction deprives market-seeking subsidiaries of access to quality inputs, reduced prices, and opportunities for subcontracting and outsourcing (Pe'er, Vertinsky, and Keil, 2016). These limitations are likely to adversely affect their efficiency and exert selection pressures both at the local and corporate levels.

In addition, the presence of relational resources such as trust reflects the munificence of the host-country environment. Trust is usually the basis on which interactions of firms are established (Powell, 1996). Not all interactions of businesses are contractual, however. Even when there are contractual bases, not every issue is in the purview of a contract. Consequently, dealing with local suppliers, distributors, and partners requires a certain element of trust. Trust helps decrease

transaction costs (Zaheer, McEvily, and Perrone, 1998). A very high income inequality has been shown to damage this important element. Costa and Kahun (2003), for example, found that greater income inequality erodes the levels of trust and civic participation in a society. Such eroded trust may prove detrimental to businesses. Fukuyama (1995) suggested that organizations operating in a society characterized by a higher level of trust fare better than those operating in low-trust societies.

Also, high income inequality affects the quality and quantity of human resource available for subsidiaries. At higher levels of inequality, human capital development, investment on education, and employee motivation become very low (Aghion, Caroli, and Garcia-Penalosa, 1999). A highly dispersed income distribution can also give way to socio-political instability and increased political risks that may pose threats to subsidiary survival. Such instability has the potential to discourage saving and investment and limit business transactions. It may also exert pressures on governments to get involved in efforts of income redistribution—efforts that may deter capital accumulation and investment (Bénabou, 1996). Recently, Davis (2015) argued that highly dispersed income/wealth distribution is associated with business exit:

> In the United States, …income inequality and wealth inequality are at their highest levels in a century…major employers go bankrupt (General Motors, Chrysler) or disappear entirely (Circuit City, Borders, Eastman Kodak, Blockbuster), to be replaced by pop-up businesses with the size and lifespan of a fruit fly….(p. 6)

Taken together, an increase in income inequality from very low levels is likely to result in a release of resources and a more munificent environment with respect to market demand, labour market conditions, and ecosystem of related and support industries, all of which are critical for market-seeking subsidiaries. Such improvement in munificence is, however, only to a certain threshold

level of income inequality. The marginal contribution of income inequality in expanding host-country resource base diminishes as income inequality increases and is likely to be negative at extremely high levels of income inequality. This leads to the following hypothesis:

> ***Hypothesis 1****: A U-shaped relationship will exist between the national income distribution level and the exit probability of market seeking subsidiaries.*

Income inequality and free-market institutional development

As with the levels of income inequality, the institutional development of host countries ranges from very low to very high levels. However, the relationship between income inequality and the development of economic institutions does not appear to be straightforward. According to standard measures, nations such as the Netherlands and most Scandinavian countries do have well-developed market-supporting institutions along with relatively lower levels of income inequality. In contrast, other countries such as Singapore and Chile have relatively well-developed market institutions, but with higher levels of income inequality (see, for example, the data summarized in Table 7). Nonetheless, income inequality and institutional development levels can interact to influence the success of foreign subsidiaries (Lawrence *et al.*, 2015). As argued above, highly egalitarian/dispersed income distribution can limit environmental munificence of the host country. Institutions are likely to provide mechanisms to mitigate the resource limitation which such extreme income distributions may generate.

Institutions provide formal and informal rules of the game that structure interactions between or among agents, including organizations (North, 1990). At a country level, institutional development generally refers to the extent to which incentive mechanisms are in place to support market operations (North, 1990; Shinkle and Kriauciunas, 2010). Institutions reduce transaction and information costs associated with exchanges, thereby reducing uncertainty and establishing a

stable structure of exchanges (Khanna, Palepu, and Sinha, 2005). In countries of high institutional development, markets are more efficient and costs associated with regulatory burdens, information asymmetries, property right protection, partner search, and contract enforcement are relatively lower (Xu and Meyer, 2013).

The extent to which highly egalitarian/dispersed income distribution discourages the formation of local support and related industries is likely to be dependent on the level of host-country institutional development. The effect is likely to be less pronounced in host countries with high institutional development, as ease of obtaining licenses, tax advantages, regulation reliefs and so forth encourages the formation of new businesses and thus expand the opportunity for market-seeking subsidiaries to access useful inputs and complementary services (Hoskinson *et al*., 2000; Khanna *et al*., 2005). Further, strong property rights in such countries provide incentives for investment and property ownership (Bowles, 2012) and hence market-seeking subsidiaries operating in these countries are likely to be constrained less by extreme income distribution in accessing resources from related and/or supporting industries. In countries with less developed institutions, the absence of a strong and reliable legal system to protect property rights is likely to exacerbate the effects of extreme income distribution on the availability of related and/or supporting industries (Lippmann *et al.* 2005).

Also, stronger protection of property rights and enforcement of contracts in institutionally developed locations facilitates the interaction of market-seeking subsidiaries with local support/related industries and reduces associated transaction costs (Williamson, 1981). Such benefits can compensate for challenges arising from, for example, resource contractions at higher levels of income inequality. Subsidiaries operating in countries with less-developed institutions operate under inefficient judicial systems and thus are more likely to suffer the consequences of

exchange partners' opportunistic behaviours (Williamson, 1981). For market-seeking subsidiaries operating in host-countries with extreme income inequality, such hazard is likely to compound the already greater selection pressure and increase exit likelihood. Efficient judicial systems encourage arm's length transactions and greater cooperation between partners (Khanna *et al*., 2005). In the absence of such a system, foreign subsidiaries need to use alternative mechanisms such as leveraging the potential of trust in cooperative undertakings (Zaheer, McEvily, and Perrone, 1998). Nonetheless, extreme levels of income inequality are likely to compromise trust and make for an even worse situation (Costa and Kahun, 2003). In locations of well-developed institutions, however, the downsides of depressed trust occasioned by extreme income inequality can be offset by the presence of an efficient judiciary system.

Another key element in defining the long-term performance of market-seeking subsidiaries is the presence of an attractive product market (i.e., demand) in the host country. North's (1990) economic institutional theory argues that the economic performance differences between nations are due largely to differences in their institutions. Better national economic performance presents market opportunities to be exploited by market-seeking subsidiaries (Brouthers *et al.* 2008). Further, high income inequality in countries with high institutional development does not necessarily imply decreased aggregate demand (or purchasing ability). The availability of credit and related financial instruments in such countries makes for easier access to products and services. Heathcote, Perri, & Violante (2010) find that in institutionally developed countries, such as the US, access to financial markets and instruments substantially limited the effects of income inequality over consumption inequality. Consequently, market-seeking subsidiaries operating in institutionally developed host countries may be less likely to suffer from limited aggregate demand associated with highly egalitarian/dispersed income distribution.

The availability of a skilled and motivated workforce is another essential element determining the munificence of the host country. Greater income inequality leads to lower human capital accumulation and economic performance (Chiu, 1998). However, such a prediction is more likely to be weaker in the context of institutionally developed countries. In such countries, better access to education and related institutions may lead to a relatively higher human capital accumulation even if there is a high level of inequality within the society. On the other hand, extreme income inequality in institutionally developed countries may not necessarily lead to a lack of skilled human power as such countries have a better potential to attract skilled labour from elsewhere. Also, the potential negative effect of extreme inequality on motivation and life satisfaction tends to be stronger in the institutionally under-developed countries than in the developed ones (Graham and Felton 2005).

Taken together, the presence of well-developed institutional structures in a host country can decrease transaction costs and promote better incentive alignment and protection of property rights. As a result, the level of institutional development weakens the negative effects of extreme income inequality on subsidiary exit such that subsidiaries operating in countries with higher levels of institutional development are less likely to suffer from the negative consequences of extreme income distributions. Likewise, foreign subsidiaries operating in countries with less developed institutions are deprived of the potential benefits of institutions and are thus more exposed to the negative effects of highly egalitarian/dispersed income distribution. These arguments lead to the following hypothesis:

> ***Hypothesis 2:*** *The U-shaped relationship between income distribution and exit probability of market-seeking subsidiaries will be negatively moderated by the level of institutional development*

METHODS

Data and sample

This study uses a very large longitudinal dataset, published annually by Toyo Keizai Inc., on Japanese subsidiaries throughout the world. To test the hypotheses, the study used 17 years of data (the 1990– 2006 period). The dataset is suitable for this study for at least two reasons. First, a study about the relationship of inequality and subsidiary exit benefits from cross-country comparisons. The dataset provides subsidiary-, MNE-, and country-level data. Second, the time series nature of the dataset enables the development of stronger causal attribution. Since the majority of Japanese foreign investments were made not long before the start of the observation (Kim et al., 2012) and subsidiary age data is included in the models (Guo, 1993), left-truncation was not a series concern.

The sample constitutes 6,699 Japanese market-seeking subsidiaries across 47 countries. In arriving at this sample, several data cleaning procedures were conducted. The study used data only from countries having a minimum of five subsidiaries so that the country-level inequality variable has sufficient subsidiary-level data. It excluded countries for which inequality data are not available. In addition, a list-wise deletion was applied for cases with missing data in any of the variables under study. To ensure that the final sample includes only viable subsidiaries for which a study of income inequality is more relevant, the study followed Beamish and Inkpen's (1998) suggestion and restricted its sample to subsidiaries having at least 20 employees. In addition, following Woodcock, Beamish, and Makino (1994), the study removed subsidiaries with fewer than two years of operation to consider only those subsidiaries that reached an initial period of stabilization.

Variables

The dependent variable consists of two components. The first represents the length of time in years a subsidiary takes to cease operation or to be right censored (i.e., not cease operation within the

time frame of the analysis). In the models, this is a random variable, whereas the censoring time is fixed to the year 2006. The second component is a censoring indicator given by the following function:

$$\delta_i = \begin{cases} 1 \ if \ T_i \leq U_i \\ 0 \ if \ T_i > U_i \end{cases} \text{.....(1)}$$

In the above function, δ_i represents a censoring result for a given subsidiary. A subsidiary is assigned 1 if T_i, that is the number of years before experiencing the event (i.e., exit), is less than U_i, that is the number of years covered by this study. If otherwise, a subsidiary is said to be right-censored because there is no way to tell when that subsidiary will experience the event. The *stset* function in STATA was used to declare the data to be survival-time data and consider two components in combination. In line with previous studies that used the same dataset, the study considered a subsidiary terminated when its records are no longer found in the dataset (Delios and Beamish, 2001). The data we use for the study are published on a yearly basis, so this is the metric for specifying time.

The key independent variable in this study is the level of inequality. The study used one of the most commonly used measures of income inequality—the Gini coefficient. Also called the Gini index, it measures the extent to which the income distribution of individuals or households in a given society deviates from a perfectly equal distribution. A coefficient of zero signifies complete equality, whereas a coefficient of 100 represents a complete inequality. The Standardized World Income Inequality Database (SWIIDv4) was used to collect Gini coefficients for the 47 countries in the analysis. The database integrates inequality data from various sources and its coverage and comparability is far better than other income inequality datasets (Solt, 2014).

The study period was divided into three (i.e., 1990-1995, 1996-2001, and 2002-2006) and average levels were used to represent the smoothed values of income inequality for the years in each period. This approach is consistent with research in the area (Forbes 2000; You and Khagram, 2005) and justified by at least two reasons. First, because exit decisions are likely to be based on trends extending over several years, it is conceptually more appropriate to use averages over a longer period rather than single year data. In fact, prior research on the distribution of income inequality data suggests that variations within countries over time explained only a very small fraction of the total variation (Li, Squire, and Zou, 1998). Second, averaging the data over a longer period helps minimize measurement error. A substantial part of the variation in income inequality within countries across time is likely to result from measurement errors and averaging helps to reduce it (You and Khagram, 2005). By considering period averages, the study treats the Gini index as a period-dependent variable in the models. That is, the hazard function for subsidiary i at time t is dependent on the value of the respective Gini index for period p and the corresponding values of the remaining variables in the model. The sensitivity of the results was tested by varying the lengths of the periods used and findings remain qualitatively similar.

The moderating variable in the study is free-market institution development. The Heritage Foundation Index of Economic Freedom measures were used to represent the level of free-market institutional development (Kane, Holmes, and O'Grady, 2007). The index aggregates measures on multiple aspects of economic freedom. It is a time series data providing indices from 1995 onwards. The index can assume values ranging from zero to 100, higher values indicating better overall economic freedom.

Table 7. Country-level data on number of subsidiaries, inequality, and institutions

Country	Region	# of sub.	Mean 1990-95		Mean 96-01		Mean 02-06		Gini Grand Mean	Inst. Grand Mean
			Gini	Inst.	Gini	Inst.	Gini	Inst.		
Rep of Korea	Asia	351	30.9	72.0	30.5	70.8	30.9	67.9	30.8	70.2
China		1,271	42.4	52.0	46.3	53.3	52.9	53.0	47.2	52.8
Hong Kong		314	34.7	88.6	43.9	89.2	46.0	89.5	41.6	89.1
Vietnam		69	34.0	41.7	35.0	41.7	38.2	47.3	35.7	43.6
Thailand		694	45.0	71.3	42.5	67.8	41.5	64.9	43.0	68.0
Singapore		440	38.4	86.3	38.3	87.2	40.6	88.2	39.1	87.2
Malaysia		319	42.8	66.7	44.2	71.9	41.3	60.9	42.8	66.5
Philippines		171	41.0	55.0	44.4	61.8	43.2	58.4	42.9	58.4
Indonesia		356	33.4	54.9	32.7	59.3	34.1	53.5	33.4	55.9
India		69	48.6	45.1	48.8	48.9	49.0	52.1	48.8	48.7
Pakistan		9	31.7	57.6	29.3	55.5	30.2	55.4	30.4	56.2
Sri Lanka		9	32.3	60.6	34.0	64.3	38.5	61.6	35.0	62.2
Iran		8	44.3	35.9	42.8	35.9	41.7	43.6	42.9	38.5
Norway	Europe	6	22.9	67.4	23.9	67.4	24.9	66.6	23.9	67.1
Sweden		15	22.2	61.4	23.2	64.2	23.3	70.3	22.9	65.3
Denmark		7	23.6	67.8	22.3	67.8	23.0	73.5	23.0	69.7
UK		280	33.8	77.9	34.3	76.7	34.5	78.7	34.2	77.8
Ireland		5	33.2	68.5	32.0	74.5	31.1	80.9	32.1	74.6
Netherlands		78	25.8	70.5	24.1	70.5	26.4	74.5	25.4	71.8
Belgium		60	23.8	64.3	26.4	64.3	26.3	69.0	25.5	65.9
France		121	28.7	64.4	28.1	59.4	27.4	59.9	28.1	61.2
Germany		242	26.7	69.8	26.7	67.0	27.8	69.7	27.1	68.8
Switzerland		16	30.6	77.7	28.2	77.7	28.1	79.2	29.3	78.2
Portugal		11	31.8	62.4	35.2	65.0	36.1	64.1	34.4	63.8
Spain		42	33.0	62.8	34.3	63.5	31.8	68.3	33.0	64.9
Italy		45	32.1	61.2	34.0	60.8	33.8	63.8	33.3	61.9
Poland		5	28.0	50.7	29.3	59.2	30.7	60.9	29.3	56.9
Russian Fed.		11	37.6	51.1	41.2	51.5	40.4	51.2	39.7	51.3
Austria		18	28.7	70.0	26.3	66.7	26.8	68.5	27.3	68.4
Czech Rep.		12	21.5	67.8	25.5	69.0	26.1	66.4	24.4	67.7
Hungary		14	29.6	55.2	29.3	59.8	27.9	63.7	28.9	59.6
Turkey		7	43.5	60.3	41.5	58.4	40.8	53.3	41.9	57.3
Canada	North America	91	28.3	69.4	30.6	69.6	31.7	69.4	30.2	71.5
USA		1,108	34.6	76.7	36.9	76.5	37.2	79.3	36.2	77.5
Mexico		55	47.4	63.1	48.0	59.1	46.0	64.8	47.2	62.3
Panama		13	50.4	71.6	50.4	71.9	49.5	66.4	50.1	70.0
Colombia	South America	7	48.3	64.5	50.3	65.1	51.0	61.9	49.9	63.8
Venezuela		9	40.3	59.8	42.5	54.9	41.5	49.2	41.4	54.6
Peru		5	51.8	56.9	54.0	66.5	50.8	63.2	52.2	62.2
Chile		9	50.1	71.2	50.3	74.6	48.9	77.3	49.8	74.4
Brazil		134	51.9	51.4	51.8	56.2	49.7	61.9	51.1	56.5
Argentina		13	42.3	68.0	44.7	71.4	44.9	56.2	44.0	65.2
Egypt	Africa	9	31.9	45.7	33.9	53.9	32.8	54.8	32.9	51.5
Nigeria		14	45.0	47.3	47.2	51.8	42.4	49.3	44.9	49.5
South Africa		7	55.9	60.7	55.9	63.5	56.6	64.8	56.1	63.0
Australia	Oceania	133	29.7	74.1	30.8	76	31.6	78.3	30.7	76.1
New Zealand		17	31.9	80.0	33.4	80.0	32.9	81.5	32.7	80.5
Subsidiaries total	-	6,699	-		-		-		-	-

Source: SWIID, Heritage Foundation, and TK dataset

As with the inequality data, yearly disturbances were smoothed and period average values were used. For the 1990-1995 period, there is only one observation and it was used in lieu of the period average. The use of the economic freedom data as a measure of free-market institutional development is common in management research (e.g., Meyer *et al*., 2009; Shinkle, Kriauciunas, and Hundley, 2013). Also, the time series nature of the data makes it compatible with the subsidiary and inequality data used.

To account for other possible alternative explanations of exit, several control variables from multiple levels were introduced. First at the subsidiary-level, control variables were introduced for a number of variables which have been shown to be theoretically related to the exit of subsidiaries. Subsidiary age variable was used to control for subsidiary age as young firms have a higher probability of dying than old ones (Carroll and Delacroix, 1982). As subsidiary size has been shown to influence exit probability of organizations (Moulten and Thomas, 1993), the study controlled for it using number of employees as its proxy. This variable is time-variant[6] and is logarithmically transformed to normalize the data distribution. Industry fixed effects were introduced to account for differences in exit likelihood of market-seeking subsidiaries associated with industry attributes.

Parent-level controls were also introduced to account for alternative explanations of subsidiary exit resulting from parent affiliation. Makino and Beamish (1998) found that the presence of multiple foreign partners increases managerial complexity, thereby influencing exit. As such, the study controlled for the number of foreign parents. Guar and Lu (2007) found a statistically

[6] To ensure that data on time-varying variables correspond to data on the variables of interest (i.e., income inequality and institutional development), period average values were used. Therefore, the time-varying variables vary across the three periods under consideration. Such approach is also logical as, in the dataset, the time-varying variables under consideration tend to vary in a fairly longer period than a year.

significant relationship between foreign-parent ownership level and subsidiary exit probability. Therefore, the study controlled for the level of foreign ownership in subsidiaries. Larger parents may have greater flexibility in reallocating resources among a broader portfolio of global subsidiaries (Delios and Beamish, 1999). Thus, parent size control was introduced and was proxied by the number of employees of the parent company. The parent size variable is time-variant and is logarithmically transformed to normalize the distribution. The study also introduced parent international experience variable as it has been shown to be related to subsidiary exit probability (Guar and Lu, 2007). The variable is measured as the combined number of years of international experience possessed by parent(s) prior to the establishment of a focal subsidiary. Intangible assets of the parent can also influence exit probability of its subsidiary (Delios & Beamish, 1999). As such, a parent-level research and development (R&D) intensity variable was included. This variable is measured as a ratio of R&D expenditure to the total sales.

Time and country fixed effects were also introduced. To control for the effects of time and crisis on the exit probability of subsidiaries, the study included period fixed effects. It did so by introducing two dummies for the three periods under consideration (i.e., 1990-1995, 1996-2001, and 2002-2006). By so doing, it can account for changes in exit probability associated, for example, with the 1997 Asian financial crisis that influenced investments from Asian countries, including Japan. The study also introduced host-country fixed effects to account for unobserved heterogeneity among the countries that may explain differences in the exit probability of foreign subsidiaries. Technically, these fixed effects allow each country to have a different intercept to capture the cross-sectional differences among the countries. This was achieved by introducing 46 country dummy variables.

Modeling procedure

To test the hypotheses, the study used fixed effects extended Cox regression. It can help estimate the parameters without the need to make any assumptions about the underlying hazard distribution. The model develops a hazard function to determine the probability that a subsidiary experiences an event (i.e., exit), given it has survived up to time t. The hazard function that is denoted by $h(t, X(t))$ is as follows:

$$h(t, X(t)) = h_0(t) \exp^{[\sum_{I=1}^{P_1} \beta_i X_i + \sum_{j=1}^{P2} \delta_i X_j(t)]} \quad \textbf{……..(2)}$$

$h_o(t)$ represents the baseline hazard function that is left unspecified and reflects the underlying hazard rate when the values of all covariates $X_1, \ldots X_{p1}$ and $X_1(t), \ldots X_{p2}(t)$ equal to 0. $\boldsymbol{X(t)}$ stands for the variables in the model and X_i denotes the i^{th} time-independent variable, while $X_j(t)$ the j^{th} time-dependent variable. β_i*'s* and δ_j's denote their corresponding coefficients. The extended Cox regression model accommodates the time-variant nature of some of the covariates used in the models (Kleinbaum and Klein, 2005) and produces a risk ratio associated with each explanatory variable. The use of Cox regression is consistent with the objectives of the study. Unlike logit and probit methods which consider whether a subsidiary has exited or not, Cox regression further relates a subsidiary's exit status to the number of years it took for a subsidiary to exit or be right-censored. Also, by introducing the exit indicator component, it corrects for issues associated with a censoring of subsidiaries which have not exited within the study period but may do so later. A fairly detailed assessment of the advantages of event history methods (of which Cox regression is one) over logit models is available in Allison (2010). Nonetheless, the robustness of the findings was checked using a fixed effects logit model and results remained consistent.

RESULTS

The study tested the main effect of income inequality on subsidiary exit using data on Japanese market-seeking subsidiaries from a globally representative sample of host countries. To further elaborate the main effect, sub-group analyses were conducted in which the dynamics in the nature of the proposed relationship and distributional differences in exit probabilities of the subgroups were examined. The study also tested the moderation effect of institutional development on the relationship between income inequality and subsidiary exit. To examine the substantive significance of the findings, statistical findings were complemented with graphical representations and discussion of effect sizes.

Table 8 presents the descriptive statistics and correlations among the variables used in the study. The correlations between the variables in the models are not so high as to cause concerns of multicollinearity. As a further diagnostic, Variance Inflation Factor (VIF) scores were calculated for the variables. Multicollinearity was not a serious concern as the VIFs for all the variables in the models were below 5 (i.e., the highest VIF being 4.3). Variables were mean centered before computing interaction terms and transformations.

The study tested its hypotheses using fixed effects extended Cox regression. Table 9 includes models used for this purpose. It used the partial likelihood procedure to estimate regression parameters. The study followed estimation procedures outlined in Singer and Willet (2003) to first fit the full model (i.e., Model 5), which includes all the variables and interaction terms. Then test of significance of the interaction and main effects were conducted by dropping one or more variables from the full model and comparing the log-likelihood of each nested model to that of the full model. The resulting Chi-square statistic was used to determine the significance of the variables or interactions excluded from the full model. Model 4 excludes interaction terms of Gini

coefficient with institutional development. Models 3 excludes the second-order Gini coefficient to test for the presence of a curvilinear relationship between income inequality and subsidiary exit. Model 2 further excludes the first-order Gini coefficient. Model 1 excludes the main effect of institutional development.

The Chi-square statistics resulting from comparing the log-likelihood of each model with that of the full model suggests that the full model offers the best fit to the data. This indicates that the introduction in the successive models of the main and interaction effects resulted in superior models. Model 2 excludes both the first-and second-order Gini coefficient variables, thus allowing for assessment of the main-effect argument. The Chi-square statistics resulting from comparing the log-likelihood of this model with that of the full model indicates that the exclusion of these variables resulted in an inferior model, suggesting the statistical significance of these variables ($\chi 2 = 38.58$, $p < 0.001$). The significant beta coefficients of these variables in the full model offer support to Hypothesis 1. That is, the linear term of the income inequality measure has a negative beta coefficient ($\beta=-0.745$, $p<0.01$), whereas the quadratic term of the same variable has a positive coefficient ($\beta=0.009$, $p<0.01$), thus lending support to Hypothesis 1. The inflection point was calculated and sub-group analyses conducted to examine the curvilinear relationship between inequality and subsidiary exit in more depth.

Table 8. Descriptive statistics and correlations

Variables	Mean	SD		1	2	3	4	5	6	7	8	9	10	11	12
Subsidiary age	13.17	9.52	1												
Subsidiary size	2.08	0.52	2	0.11											
Ownership ratio	75.63	27.54	3	0.12	-0.13										
Number of foreign parents	1.52	0.97	4	-0.11	0.08	-0.14									
Parent size	4.60	4.76	5	0.01	0.18	-0.01	0.12								
Parent R&D intensity	4.76	4.89	6	0.02	0.13	0.02	0.00	0.79							
Parent international experience	14.30	10.69	7	-0.44	-0.02	-0.07	0.09	0.05	0.01						
Industry dummies	-	-	8	0.06	-0.21	0.11	-0.11	0.02	0.07	0.01					
Year dummies	-	-	9	0.16	0.07	0.06	0.01	-0.01	-0.09	0.06	-0.20				
Country dummies	-	-	10	0.25	-0.11	0.30	-0.12	0.01	0.06	-0.09	0.17	-0.13			
Institutions	68.30	12.14	11	0.29	-0.19	0.30	-0.14	-0.05	0.03	-0.18	0.25	-0.18	0.24		
Gini coefficient	39.69	6.87	12	-0.16	0.12	-0.15	0.13	0.03	0.00	0.19	-0.18	0.26	-0.30	-0.43	
Subsidiary survival	6.37	4.17	13	0.49	0.19	0.05	-0.02	0.02	-0.04	-0.14	-0.11	0.66	0.03	0.07	0.03

Correlation coefficients greater or equal to |0.05| are significant at a 5% level.

Table 9. Results from the extended Cox regression model

Independent Variables	**Model 5**	**Model 4**	**Model 3**	**Model 2**	**Model 1**
Controls					
Subsidiary age	-0.044***	-0.044***	-0.045***	-0.045***	-0.047***
	(0.003)	(0.003)	(0.003)	(0.003)	(0.003)
Subsidiary Size	-0.832***	-0.827***	-0.843***	-0.843***	-0.809***
	(0.041)	(0.041)	(0.041)	(0.041)	(0.040)
Ownership ratio	-0.005**	-0.005**	-0.004**	-0.004**	-0.006**
	(0.001)	(0.001)	(0.001)	(0.001)	(0.001)
Number of foreign parents	-0.162***	-0.161***	-0.172***	-0.169***	-0.162***
	(0.025)	(0.025)	(0.025)	(0.025)	(0.025)
Parent size	4.19e-07	4.17e-07	5.41e-07	4.80e-07	6.70e-07
	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)
Parent R&D intensity	2.26e-06*	2.24e-06*	2.18e-06*	2.23e-06*	2.11e-06*
	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)
Parent international experience	0.012***	0.012***	0.011***	0.012***	0.012***
	(0.002)	(0.002)	(0.002)	(0.002)	(0.002)
Industry dummies	Included	Included	Included	Included	Included
Year dummies	Included	Included	Included	Included	Included
Country dummies	Included	Included	Included	Included	Included
Main effects					
Institutions	-0.198*	-0.006**	-0.010***	-0.011***	
	(0.084)	(0.002)	(0.002)	(0.002)	
Gini coefficient	-0.745**	-0.137***	0.007*		
	(0.266)	(0.027)	(0.003)		
Gini coefficient^2	0.009**	0.002***			
	(0.003)	(0.000)			
Interactions					
Gini coefficient × Institutions	0.010*				
	(0.004)				
Gini coefficient^2 × Institutions	-0.001*				
	(0.000)				
Number of subsidiaries	6,699	6,699	6,699	6,699	6,699
Number of countries	47	47	47	47	47
Log likelihood	-29,334.35	-29,337.26	-29,350.71	-29,353.63	-29,375.06
$\chi 2$ model against null model	2,261.38***	2,255.56***	2,228.64***	2,222.80***	2,180.09***
$\chi 2$ model against Model 5	N/A	5.82*	32.74***	38.58***	81.17***
AIC	58,698.69	58,700.51	58,725.43	58,729.27	58,769.86

*p<.05; **p<.01; ***p<.001(two-tailed)
Standard errors in parentheses.

The inflection point was estimated to be at a Gini coefficient of 38[7]. Consistent with a procedure used by Hitt, Hoskisson, and Kim (1997), extended Cox regression models were fitted by classifying the entire sample into two subgroups: subsidiaries operating in countries with Gini scores of up to 38 (n1=3,380) and those operating in countries with Gini scores of above 38 (n2=3,319). In doing so, the intention was twofold. The first was to corroborate the finding of a curvilinear relationship by calculating slopes for the relationship at both below and above the inflection point. As Table 10 shows, in line with the theory and empirical evidence discussed earlier, the relationship between the Gini coefficient and subsidiary exit is negative to the left of the inflection point, but positive to the right. The second intention was to compare effect sizes or the sensitivity of subsidiary exit to changes in Gini indices across the two subgroups. The model for subgroup 1 indicates that the rate of subsidiary exit decreases by about one percent for a unit increase in Gini coefficient, ceteris paribus. In contrast, the model for subgroup 2 suggests that the chance of subsidiary exit increases by about 3 percent for a unit increase in Gini coefficient. This implies that the sensitivity of change in exit rate is slightly greater at higher levels of income inequality (i.e., above the inflection point).

In a separate post-hoc analysis, extended Cox regression models were run for three subsamples: subsidiaries operating in locations of low inequality (i.e., Gini indices of at most 34 or below -1SD of the mean), moderate inequality (i.e., Gini indices of between 34 and 45 or between -1SD and

[7] $\lambda(x) = e^{\left((-0.1369x)+0.0018x^2+\cdots\right)}$

Calculate the partial derivative of the hazard function with respect to x (i.e., $\frac{\partial\lambda(x)}{\partial x}$)

And set $\frac{\partial\lambda(x)}{\partial x} = 0$ to find the inflection point

$$=> \frac{\partial\lambda(x)}{\partial x} = e^{\left((-0.1369x)+0.0018x^2+\cdots\right)} * (-0.1369 + 0.0036x) = 0$$

If (-0.1369 + 0.0036x) = 0, then $\frac{\partial\lambda(x)}{\partial x}$ *= 0. Thus,* $0.0036x = 0.1369$ $=> \underline{x \simeq 38}$

+1SD of the mean), and high inequality (Gini indices of at least 45 or above +1SD of the mean). Figure 5 shows that over time subsidiaries operating in host countries with moderate Gini indices

Table 10. Results from subgroup analyses

Independent Variables	**Subgroup 1**			**Subgroup 2**		
	β (s.d)	**95% Conf. Interval**		**β (s.d)**	**95% Conf. Interval**	
Subsidiary age	-0.040***	[-0.048	-0.034]	-0.052***	[-0.062	-0.043]
	(0.004)			(0.005)		
Subsidiary Size	-0.872***	[-0.985	-0.758]	-0.792***	[-0.908	-0.676]
	(0.058)			(0.059)		
Ownership ratio	-0.006***	[-0.008	-0.004]	-0.005**	[-0.007	-0.003]
	(0.001)			(0.001)		
Number of foreign parents	-0.168**	[-0.253	-0.083]	-0.156***	[-0.218	-0.094]
	(0.043)			(0.032)		
Parent size	$-1.61e^{-07}$	[$-1.47e^{-06}$	$1.15e^{-06}$]	$-0.4.35e^{-08}$	[$1.35e^{-06}$	$1.27e^{-06}$]
	(0.000)			(0.000)		
Parent R&D intensity	$2.69e^{-06}$*	[$1.80e^{-06}$	$3.58e^{-06}$]	$2.90e^{-06}$*	[$1.97e^{-06}$	$3.82e^{-06}$]
	(0.000)			(0.000)		
Parent international experience	0.011***	[0.006	0.016]	0.014***	[0.008	0.019]
	(0.003)			(0.003)		
Industry dummies	Included	-		Included	-	
Year dummies	Included	-		Included	-	
Country dummies	Included	-		Included	-	
Institutions	-0.013	[-0.019	-0.006]	-0.005	[-0.011	0.001]
	(0.003)			(0.003)		
Gini coefficient	-0.013*	[-0.019	-0.007]	0.034*	[0.019	0.050]
	(0.003)			(0.007)		
Number of subsidiaries	3,564			3,135		
LR chi2	1, 430.49			859.03		
Log likelihood	-15,694.259			-11,497.354		
Prob > chi2	0.00			0.00		

Note: Subgroup 1 is made up of observations with Gini Coefficient of less or equal to 38; whereas, subgroup 2 consists of observations with Gini Coefficient of greater than 38.
*p<.05; **p<.01; ***p<.001 (two-tailed)

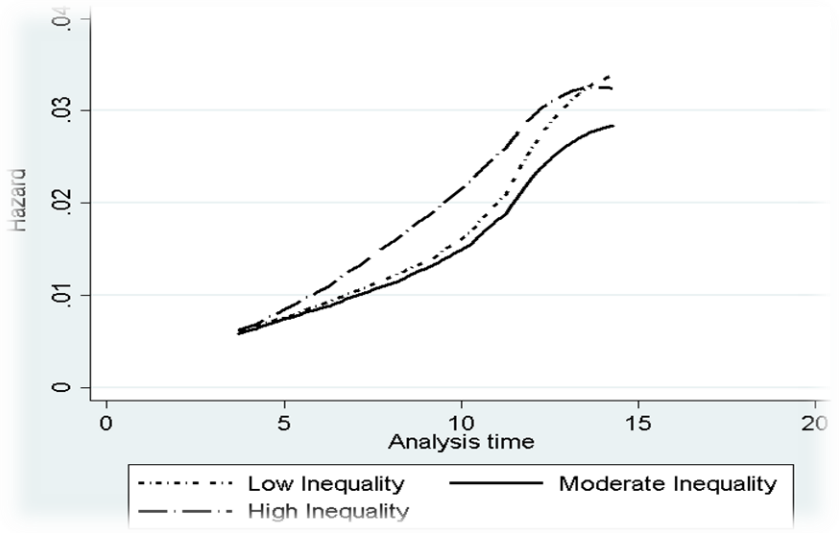

Figure 5. Smoothed hazard estimates for subgroups of subsidiaries

experience a lower likelihood of exit than their counterparts, providing additional support to the proposed curvilinear relationship.

Model 4 in Table 9 serves to test the moderating effect of institutional development in the inequality-subsidiary exit relationship. Excluding interaction effects of the linear and quadratic forms of the Gini coefficient with the institutional development variable results in an inferior model, suggesting the presence of a significant interaction effect ($\chi 2 = 5.82$, $p < 0.05$). Results in the full model (i.e., Model 5) support Hypothesis 2 as the coefficient for the interaction of institutional development with the linear term of Gini coefficient is positive ($\beta = 0.01$, $p < 0.05$) and negative with the quadratic term of the Gini coefficient ($\beta = -0.001$, $p < 0.05$). This suggests that institutional development attenuates the curvilinear relationship between income inequality and subsidiary exit.

A battery of robustness tests was conducted to examine the sensitivity of the findings to variations in the study sample, source of data, and model specification. To examine whether the results are

driven by outliers in the sample, the models were reestimated for different sample compositions. A potential problem is that the results might be influenced by an unusual data distribution of one or more countries. To explore such possibility, models were run by removing five countries with the lowest and highest average values for the variables of interest (i.e., income inequality and institutional development). While the values of the estimates did fluctuate, their signs and statistical significances remain unaltered.

Also, the models were rerun using alternative data sources for each of the main independent variables. While the SWIID used in the analysis provides the most comprehensive and comparable Gini data, it was essential to verify the sensitivity of the results to the use of Gini data from another source. Consequently, the models were reestimated using the World Bank's Gini data[8]. Similarly, Models were rerun by considering the World Bank's Governance indicator (Kaufmann, Kraay, and Mastruzzi, 2005) as an alternative proxy to institutional development. In each case, the signs and significances of the coefficient estimates did not change. Another potential problem with the results of the study arises from region-specific differences that may influence inequality levels. To control for this effect, the sample countries were classified into six regions namely Asia, Europe, North America, South America, Africa, and Oceania and models were respecified by including five region dummies. Results remain robust.

While the use of the fixed effects estimation can control for potential endogeneity concerns arising from omitted variables, other potential sources of endogeneity remain. The income inequality variable in the models might be endogenous as it could be affected by the actions of the

[8] Average indices were used for each country as they are measured at different times for different countries and only a single observation was available for over a third of the countries.

subsidiaries. It could be the pattern in the exit of the subsidiaries that is shaping host country income distribution. As well, there might be a possibility that market-seeking subsidiaries self-select into countries with certain levels of income distribution. To mitigate such endogeneity concerns, a two-stage instrumental variable approach was used. This approach requires identifying an exogenous variable strongly correlated with the independent variable (i.e., income inequality), but not with the error term in the second stage model (Semadeni, Withers, and Certo, 2014). Following prior literature (Easterly and Levine, 1997; Siegel, Licht, and Schwartz, 2013), host-country *ethnic fractionalization* and its squared term were used as instrumental variables. Data on ethnic fractionalization compiled by Alesina *et al*. (2003) was used and a two-stage residual inclusion (2SRI) approach was applied. This approach generates unbiased and consistent estimates from non-linear second stage models such as Cox regression model (Hausman, 1978; Terza, Baus, and Rathouz, 2008). Results of the study remain robust.

DISCUSSION

Income inequality is a global phenomenon. However, some countries have more of it than others, as shown in Table 7. Our understanding of its potential relationship with business performance has been limited at best. The major objective of this paper is to make a modest contribution in this respect. It argues that the relationship between income inequality and foreign subsidiary exit can be complex both in terms of its fundamental nature and in its associated contingencies. The empirical evidence supports a curvilinear relationship between inequality and subsidiary exit. It was found that an increase in income inequality from the lowest point to the inflection point is accompanied by a corresponding decrease in the exit probability of market-seeking subsidiaries. This observation suggests that market-seeking subsidiaries operating in such countries as the Netherlands (i.e., average Gini of 25.4) tend to benefit from increasing inequality, as such increase

corresponds with a reduction in their exit probability. In this respect, Sweden's experience is telling: an increase in its Gini coefficient has been associated with a greater economic efficiency (The Economist, 2012) which can, in turn, decrease the chances of subsidiary exit.

The relationship between subsidiary exit and income inequality follows a different pattern after the inflection point. The benefits of increasing income inequality to subsidiaries, in terms of decreasing their exit probability, reaches maximum levels at this point. Beyond this point, increases in inequality tends to introduce resource limitations, resulting in increased exit likelihood. This finding is consistent with the argument that an increase in income inequality engenders multifaceted challenges (see for example, Bénabou, 1996; Easterly 2007) that can increase subsidiary exit probability.

The general finding of a non-monotonic relationship of inequality and subsidiary exit is consistent with that of Hasanov and Izraeli (2011) who found an inverted U-shape relationship between inequality and economic growth. They identified that in the United States, state-level Gini scores of below 0.17 or above 0.50 were associated with negative growth rates and the highest rates of growth occur when the Gini values are in the 0.33 to 0.35 range. Since business entities form a significant part of a given economy and are directly affected by trends in economic development, this finding can be considered an extension to the organizational level of the similar pattern they observed at a macro-level. Similarly, the findings of this study are in line with that of Lippmann *et al*.(2005) in which they found a similar form of relationship between economic inequality and the formation of opportunity-based ventures that can support operations of subsidiaries in their host-country.

A closer look at the relationship between income inequality and subsidiary exit reveals an interesting insight. The findings suggest that subsidiaries operating in countries occupying symmetrical positions with respect to the inflection point (for example, Austria with an average Gini of 27.3 and Thailand with an average Gini of 43) can have a roughly equal chance of exit. Nonetheless, the sensitivity of the outcome (i.e., subsidiary exit likelihood) to changes in inequality levels differs across the countries. A move to a less egalitarian society in Austria is likely to be in the best interest of subsidiaries operating there as it, on average, decreases their exit likelihood. However, such a move in Thailand will likely have the opposite implication. Instead, a move to a more egalitarian society in Thailand may be required to improve environmental munificence and thereby decrease exit likelihood of subsidiaries. This insight extends the arguments in the market attractiveness literature that emphasizes aggregate (e.g., GDP) and average (e.g., Income Per Capita) income characteristics by suggesting that dispersion (variance) of income is also an important indicator.

Further post-hoc analyses confirm the results. First, as presented in Figure 5, subsidiaries operating in locations with moderate income inequality levels have, on average, a lower probability of exit than those operating elsewhere. Further, sub-group analyses of subsidiaries operating in countries with different levels of inequality (i.e., below and above the inflection point) provide evidence supporting the hypothesized non-monotonic relationship. Generally, the results indicate two ways of decreasing subsidiary exit associated with income inequality: high income inequality countries ought to work towards reducing income inequality; whereas, low income inequality countries need to adopt policies that can push their inequality levels to intermediate levels. However, the subgroup analyses indicate that high inequality countries have more to benefit, in terms of reduced subsidiary

exit rate, from reduced income inequality than do low inequality countries from increased income inequality.

The results of the study also show another layer of complexity in the relationship between inequality and subsidiary exit. It was found that host-country institutional development moderates the relationship between income inequality and subsidiary exit. As depicted in Figure 6, across different levels of inequality, subsidiaries operating in countries with high institutional development have a lower exit probability than their counterparts operating in countries with low institutional development. This suggests that institutional development improves environmental munificence and thus counterbalances host-country resource limitations associated with extreme income distributions, thus highlighting the need to consider the interaction of institutional

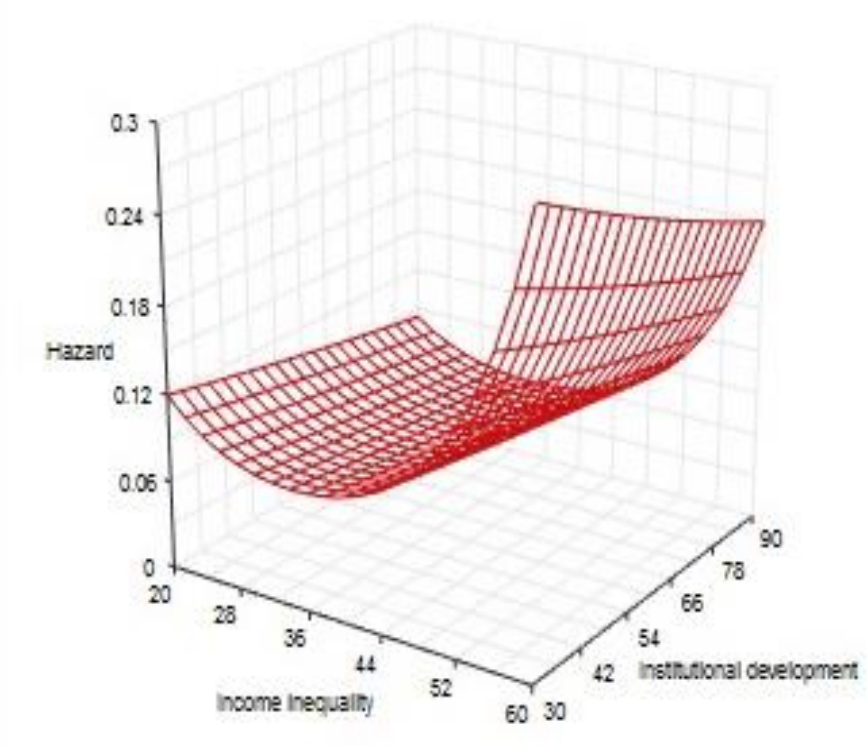

Figure 6: Interaction between income inequality and institutional development

development and income inequality in examining potential hazards facing market-seeking subsidiaries. The results of this study inform MNEs' market-seeking investments in at least three important ways. First, they stress the importance of considering income distribution within a country when assessing investment potential and performance. Second, they highlight the dynamics between the levels of income inequality and subsidiary exit and how a move to a more/less egalitarian society relates with subsidiary exit depending on the prevailing level of income inequality. Third, they show how the relationship of income inequality and subsidiary exit can be contingent on host-country institutional development.

However, certain limitations and future directions should be noted. First, the proxy used for inequality is the Gini coefficient. In spite of its widespread use, this measure may not perfectly capture the construct—income inequality. Recent works in economics, for example, have used ratio measures such as *top 5 percent shares* that provide information about what percentage of the total national income is accounted for by the top 5 percent of the population (Piketty and Saez, 2006). Future research can test the robustness of the findings by using alternative indicators of income inequality. Second, the empirical tests are based on data from Japanese MNEs and subsidiaries. As such, before any generalization can be made, the study needs to be replicated using subsidiary and MNE data from other home countries. It should be noted, however, that the use of a single home country data serves an essential statistical purpose of controlling for variance arising from home-country heterogeneity.

Future research needs to look at institutional antecedents/underpinnings of economic inequality, as such research may provide a more refined understanding of how inequality is associated with business termination. Research in the varieties of capitalism stream has been looking at the institutional differences across different versions of capitalism and how different institutional

arrangements can give rise to different levels of income inequality (Judge, Fainshmidt, and Brown, 2014). Future studies on economic inequality and business exit can clearly draw on this literature to produce more refined insights. Another fruitful direction is to empirically examine the relationship between income inequality and environmental munificence. The study wove together relevant theoretical arguments to establish the relationship between the two and connect income inequality with foreign subsidiary exit. However, empirical investigations of the underlying relationship would not only help verify the robustness of the findings but also make for a nuanced understanding of the ways through which inequality influences resource dynamics of the environments in which subsidiaries operate.

We also see potential in a single host-country replication of this study so that the focal locus shifts from countries to regions, provinces, or cities. Do regional, provincial, or city differences in income distribution explain differences in the loss/retention of market-seeking subsidiaries? These are questions of considerable practical as well as theoretical import. For example, Reich (2014) argued that an unequal distribution of income was responsible for Detroit's economic problems. Future empirical research looking at the causal link between income distribution and business exit can help advance better understanding, while also testing Reich's thesis.

CONCLUSIONS

Davis (2015) identified income inequality as one of the three most important topics organization and management researchers need to study. To the best of our knowledge, this study is among the first to directly examine the relationship between income inequality and subsidiary exit. The study finds empirical support for the relationship between inequality and subsidiary exit probability. In particular, it finds a non-monotonic association between inequality and subsidiary exit in that the relationship between the two is negative at lower levels of inequality but positive at higher levels

of inequality. This finding is important as it shows the complex ways in which income inequality relates with the exit of market-seeking subsidiaries.

The study also examined whether income inequality interacts with institutional development to affect subsidiary exit likelihood. It finds that institutional development mitigates potential resource limitations wrought by income inequality and facilitates coordination inside the subsidiary and outside in the product as well as factor markets. This finding, therefore, suggests that market-seeking subsidiaries operating in countries with very high income inequality and low institutional development have a greater likelihood of exit than such subsidiaries operating elsewhere.

The results of this study have important theoretical as well as managerial implications. From a theoretical standpoint, this research makes a case for the influence of socio-economic forces on subsidiary performance. It contributes to the stream of literature examining the effects of environmental influences on subsidiary exit. In fact, a fundamental question in IB scholarship is how environmental context influences foreign subsidiary performance and MNE behavior (Dunning and Lundan, 2008). Clearly, understanding how social forces influence business performance and what businesses (or governments) have to do to manage these forces has considerable theoretical merit.

From a practical standpoint, the research suggests the need for organizations to consider socio-economic forces more closely and critically. Particularly, the study shows how the probability of subsidiary exit changes along different levels of income distribution. In addition, this study provides firms with useful information about exit risks associated with different investment locations having different income distributions. Finally, for host country governments, the results

provide empirical evidence about when and how inequality relates to business exit, thereby informing their policy decisions.

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CHAPTER FOUR

The Collective-Relational Approach to Political Connection: A Case for Political Rent?

INTRODUCTION

> *"China does not have a competitive edge over its Western counterparts in an open market. But in a closed market like Africa's, Chinese companies are able to gain from government influence,"* - a Beijing-based energy consultant, January 2006[9].

MNEs from the advanced economies have long dominated trade and FDI flows throughout the globe. However, this extended domination has been threatened lately by new MNEs from the emerging markets. Unlike their counterparts from the advanced economies, most MNEs from such emerging markets as the BRICS[10] are newcomers to the global scene and thus need to find unique ways to thrive amid the challenges and multifaceted threats characterizing cross-border investments. The introduction to the global competitive environment of these new MNEs has been surfacing some important aspects of competitive advantage. The Sino-African case can be illuminating in this respect. In 2009, China surpassed US as the largest single country trading partner of Africa (OECD, 2011). Similarly, Chinese outward FDI to Africa has been rapidly increasing over the last decade, while MNEs from the developed economies have continued to divest from continent (UNCTAD, 2015). As well, on average, the performance in Africa of Chinese MNEs compares favorably with that of their Western counterparts (Alden & Davies, 2006; Stevens and Newenham-Kahindi, 2017). What underlies such a performance edge? Answering this question can provide important theoretical as well as practical insights.

The resource-based view (RBV) holds that competitive advantage can result from possession of valuable and rare organizational resources (Barney, 1991; Peteraf, 1993). Here, emphasis is on

[9] China: Greasing wheels in Africa', Energy Compass, 20 January 2006.
[10] An acronym that stands for Brazil, Russian Federation, India, China, and South Africa

resources found inside the organization as potential sources of competitive advantage. Dyer & Singh (1998) extended the RBV argument by suggesting that organizational resources that provide competitive advantage can be outside the organization and be embedded in the networks of relationships the organization forms with others such as suppliers, distributors, and partners. Drawing on the network and embeddedness literature in economic sociology (e.g., Granovetter, 1985), Dyer & Singh (1998) offer useful insight on the locus of valuable and rare resources.

However, Dyer & Singh (1998) considered only relationships in the market and did not consider possible non-market relationships. Developments in the IB literature and non-market strategy literature, however, have long acknowledged the strategic importance of relationships with governments (e.g., Boddewyn, 2016; McWilliams, Van Fleet, and Cory, 2002; Schuler, Rehbein, and Cramer, 2002). Research in these areas has also pointed to potential downsides of direct political connections—downsides that may adversely affect the competitive position of the business in question (Okhmatovskiy, 2010; Sun, Mellahi, and Thun, 2010).

Direct political relationships confer useful political resources; creating and maintaining these relationships may be costly, however. Indeed, assuming the norm of rationality, organizations will choose to build political relationships when their potential benefits outweigh their costs. In contrast, the dynamics between benefit and cost distributions is likely to change when the political relationships are indirect as in the case of the Chinese modified one-tier bargaining model—a model especially used to support resource-seeking investments of state-owned MNEs (Li, Newenham-Kahindi, Shapiro, and Chen, 2013). In this model, the Chinese government directly bargains strategic and operational entry deals on behalf of a consortium of Chinese companies. These companies receive financial and infrastructural supports from the Chinese government and are expected to operate in a predetermined host country. In this bargaining model the Chinese

government provides development assistance to the host country in the form of low-interest loans, infrastructural development, and grants in return for the host country providing investment opportunities and facilitating entry and local operations of the Chinese MNEs.

This study builds on Hillman & Hitt's (1999) arguments about the nature of political actions in order to put forward a theoretical explanation for political connections and their implications on MNE competitive advantage in developing countries. It conceptualizes the modified one-tier bargaining model as a relational and collective approach to political connection and argue that this approach enables Chinese MNEs to access useful political resources, without the direct costs involved in creating and maintaining the linkage. Further, it puts forward theoretical arguments suggesting that the relational aspect of this approach confers pragmatic legitimacy on the Chinese subsidiaries. These gains in resources and legitimacy arising from the unique bargaining model are likely to serve as mechanisms linking political connection and competitive advantage. The bargaining model creates an imperfect factor market for political resources—a market in which Chinese companies have a substantial access to political resources, with potential performance returns. We view such returns as *political rents*.

As well as its potential contribution to the stream of literatures concerned with identifying the locus of critical resources and specifying the condition in which political resources can make for competitive advantage, this paper seeks to achieve the following five purposes. First, by considering alternative governance mechanisms to structure non-market exchanges/transactions between or among MNEs and governments (i.e., host and home), the study seeks to contribute to a better understanding of the different approaches to political connection and their respective implications for market competitiveness. Examination of the special governance mechanism characterizing investment of Chinese SOMNEs helps us responds to a call by Wright *et al*. (2005)

for a greater understanding of emerging market multinationals and the implications of their strategic orientations for extending or refining existing theories.

Second, the study brings to the fore the issue of MNE- host country bargaining—an issue that has received only limited attention despite its key role in informing early IB research (Eden, Lenway, & Schuler, 2004; Ramamurti, 2001; Vernon, 1971). The MNE-host government relationship is vital as it affects virtually every aspect of MNE's strategy and performance. This research addresses the political dimensions of international business and has considerable theoretical appeal. In fact, scholars have argued that this is an area in the IB literature with considerable promise for building a unifying IB theory (Dunning, 1993; Rodriguez, Siegel, Hillman, Eden, 2006; Grosse and Behrman, 1992). Third, by examining the roles of host and home governments in the bargaining process, the study brings the State back in to IB research and contribute to resolving the limitation that most IB research is too MNE-centric (Hennart, 2009) and treats as exogenous host-country politics and the state (Agmon, 2003). Likewise, by looking at the strategic interaction between national states and MNEs, it departs from IB research that examines MNEs' exchanges in the (economic) market and consider the nature and implications of exchanges in the political market.

Fourth, it seeks to contribute to IB/strategy research in emerging markets and specifically to the literature focusing on how MNEs deal with institutional voids—absence or lack of market-supporting institutions (Mair and Marti, 2009). Whereas MNEs employ non-market strategies to mitigate economic challenges institutional voids pose (Dorobantu, Kaul, and Zelner, 2016; Getachew and Beamish, 2017), understanding the nature of these international political strategies is limited. By introducing a typology of approaches used to structure exchanges between host countries and MNEs and examining their implications for the divestment of foreign subsidiaries,

the study intends to advance the extant understanding of such strategies. Fifth, the research indicates potential for integrating perspectives from the RBV and the resource dependence perspective to explain competitive advantage. Here, the study argues that the bargaining model characterizing the entry of Chinese MNEs elicits the complementary aspects of resource mobilization and legitimacy in helping subsidiaries secure competitive advantage.

The following sections include discussion of related literature on political connections, sources of competitive advantage, and MNE-developing host government bargaining models. These are followed by the development of a typology of alternative governance structures (bargaining models). The next part presents five propositions regarding the relationships between these governance structures and the competitive advantage of foreign subsidiaries as well as the associated mechanisms and boundary conditions. Finally, the implications of this study for further theoretical development and practice are discussed.

THEORETICAL DEVELOPMENT

Developing countries feature contexts starkly contrasting to those elsewhere. MNEs operating in these markets, for instance, need to deal with or mitigate challenges from greater levels of institutional voids. Information asymmetries, weak property right protection, and higher monitoring and enforcement costs plague MNE investments in locations of high institutional voids (e.g., Hoskisson *et al*., 2013; Wright *et al*., 2005; Xu & Meyer, 2012). Likewise, unstable political, economic, and institutional conditions constrain such managerial undertakings as planning and adapting (Delios and Henisz, 2000; Henisz, 2000). Unlike those in advanced markets, states in emerging markets play a more active role in not only regulating foreign firms but also running their own business enterprises (i.e., state-owned enterprises) (Xu & Meyer, 2012). In emerging markets, the political environment (of which the state is an integral part) is key and influences the

strategy and performance of foreign subsidiaries. For example, a recent study of 150 North American and European-based MNEs operating in Africa indicated that many of them incurred significant losses mainly due to regulatory issues and bribery (Hochberg, Klick, & Reilly, 2015).

Given the challenging operating environments and active role of states in emerging markets, MNEs often find it essential to forge political connections or partake in the political market (Faccio, 2006). This is especially true of emerging-market MNEs (EMNEs), most of which consider politics an integral part of their business (Park and Luo, 2001; Wang *et al*., 2012). For example, Chinese MNEs leverage *Guanxi* and government ties to substitute for weak institutional arrangements as well as facilitate their international expansion (Wang *et al*., 2012). These connections afford strategic advantages through better access to useful information and protection from political hazards (Faccio, Masulis, and McConnell, 2006; Hillman and Hitt, 1999). Like economic markets, political markets entail exchanges/transactions. Connected MNEs need to provide something in return for the strategic advantages states set at their disposal (Bonardi, Holburn, and Bergh, 2006). Connected MNEs may be required, for example, to keep excess employment, pay higher wages, or even financially support the ruling party of the state (Brockman, Rui, and Zou, 2013).

Competition within economic markets is an integral subject of emphasis in international business practice as well as scholarship. However, the notion of competition has been extended less to political markets in which policies, information, and financial supports are exchanged (Bonardi *et al*., 2006; Hillman and Hitt, 1999). Competition in the political market, like in economic markets, requires deployment of organizational resources and adoption of apposite strategies, called political strategies (Boddewyn & Brewer, 1994; Hillman & Hitt, 1999). Political strategy of a firm represents, "…those actions taken to favorably position the firm in its nonmarket environments by

managing those uncertainties and resource dependences stemming from the influence and/or resistance of other nonmarket actors that (can) affect the firm's overall economic performance'' (Mahon, 1993; p. 196). Of interest here is a political strategy MNEs employ to structure their relations with host-country governments. Whereas earlier research in the area has considered the rationale behind such strategies (e.g., Brockman *et al.*, 2013; Faccio *et al.*, 2006), we have limited understanding of the different types of political strategies employed by MNEs with disparate experiential backgrounds (for example, MNEs from advanced markets vs EMNEs) and the relative performance implications of these strategies.

An important aspect of MNEs' political strategy in their respective host country is the bargaining model they adopt to structure their relationship with the host government (Ramamurti, 2001; Vernon, 1971). The chosen MNE-host country bargaining model governs the interaction between MNEs and their respective host government. Bargaining between the two parties determines, among other things, MNE entry to and performance in the host-country (Boddewyn, 2016; Eden *et al*., 2004; Nebus & Rufin, 2010; Ramamurti, 2004; Vernon, 1971). These bargaining parties have different natures and responsibilities, resulting in clear conflicts of interests and goals. MNEs are business organizations and thus are accountable to their owners; whereas, host-governments are political entities whose accountability is to the society in the host country. Whereas MNEs' overriding purpose is to maximize returns (i.e. profits) (Friedman, 1970), host governments look to maximize returns (e.g., tax revenue, job opportunities) from the MNEs. While the bargaining is to develop mechanisms for mutual satisfaction of their interests, contracts arising from the bargaining process are hardly complete and threats of opportunistic behavior abound.

Incompleteness of contracts and potential for opportunistic behavior translate to greater uncertainty and transaction costs. Expropriation is a potential manifestation of such opportunistic

behavior. Expropriation may take a direct or an indirect form. Direct expropriation involves a situation where an MNE is forced by the host-government to relinquish its ownership rights on its investment in the host-country. Indirect expropriation takes the forms of deliberately tampering with the environment to make it hostile for the MNE to operate. Included in this form of expropriation are excessive taxation, exchange rate manipulations, bribes, and new permit requirements (Azzimonti & Sarte, 2007). In recent decades, direct expropriation has increasingly made way for indirect expropriation as host-governments have come to realize that more value can be had through the latter than the former (Chifor, 2002).

A key theoretical question is, therefore, how best to align the incentives of the exchange partners, resolve attendant conflict of interest, and minimize hazards from opportunistic behaviours. This study builds on Hillman and Hitt's (1999) arguments about the nature of political actions to identify alternative governance structures (or bargaining models) used for organizing MNE-host government exchanges. In so doing, it extends the argument of alternative governance structures to organize economic transactions to the realm of the political market where policies, regulations, information, and financial supports are exchanged (Bonardi, Hillman, & Keim, 2005; Hillman and Hitt, 1999). Also, by integrating insights from the Transaction Cost Politics (TCP) literature, the resource-based view, and the social capital perspectives, the study examines the implications of these governance structures for competitive advantage of foreign subsidiaries. Such competitive advantage is assumed to reflect the effectiveness of a governance structure. Further, it identifies potential institutional boundary conditions by considering whether and how the development of host-country economic and political institutions determine the effectiveness of a governance structure.

SOURCES OF COMPETITIVE ADVANTAGE

The RBV holds that valuable and rare resources and capabilities undergird competitive advantage (Barney, 1991; Peteraf, 1993). While anything thought of as a strength or weakness can be a resource (Wernerfelt, 1984), three broad categories are widely recognized. These categories include physical capital resources, human capital resources, and organizational capital resources (Barney, 1991). While it is generally accepted that resources and capabilities are possessed by organizations, relatively little attention has been paid to their origin. Barney (1986) discussed this issue and suggested that organizations acquire critical resources from strategic factor markets. However, even here the source of resources is discussed in aggregate.

Dyer & Singh (1998) addressed the same issue of locus of critical resources and capabilities, but with some degree of specificity. They suggested that some critical organizational resources may span boundaries and be embedded in the inter-firm relationships with suppliers, distributors, and partners. This work extended the RBV arguments in two ways. First, it advanced the notion that inter-firm linkages can give rise to valuable, rare, and inimitable resources and capabilities. In the traditional RBV literature, limited attention was paid to relationships as important sources of critical resources and capabilities. Indeed, the organizational capital resources category includes "…informal relations among groups within a firm and between a firm and those in its environment," (Barney, 1991: 101). However, little research looked at the micro-foundations of resources as potential explanation of competitive advantage. Even in Barney's (1991) definition, only informal relations are considered, with no room for the formal and regular relationships a firm may have and out of which it secures valuable, rare, and inimitable resources and capabilities.

Second, Dyer & Singh (1998) contributed to Barney's (1986) earlier work on the strategic factors market concept that concerns the ultimate sources and locus of critical resources and capabilities.

By drawing on an earlier work in economic sociology on embeddedness (Granovetter, 1985), Dyer & Singh (1998) identified inter-firm linkages as useful sources of strategic factors. Unlike other sources of strategic factors, inter-firm linkages enable access to several different types of resources and capabilities such as information and financial resources. Nonetheless, such linkages also need to be maintained on a regular basis, and clearly some costs would be incurred for that purpose.

The emphasis in Dyer & Singh (1998), however, is on market-based inter-firm linkages; the relationship firms form is conceptualized as one with parties actively involved in the firm's value chain, namely upstream and downstream strategic alliance partners. However, developments in the IB and non-market strategy literatures pointed to non-market (political) relationships. Boddewyn & Brewer (1994), for instance, argued that international business fundamentally differs from domestic business in the greater attention accorded to political factors and the relationship with governments of different host countries. They suggested a move away from considering political forces merely as constraints and emphasized the value to international business managers of appreciating the merits of developing a political behavior capability. Table 11 presents a summary of related research in IB and non-market strategy.

Political behavior involves, "…the acquisition, development, securing, and use of power in relationship to other entities, where power is viewed as the capacity of social actors to overcome the resistance of other actors," (Boddewyn & Brewer, 1994: 120). It is conceptualized as an important source of political resources and capability. These political resources and capabilities entail "…intelligence and cognitive maps about non-market environments, better access to

Table 11: Summary of IB/strategy research on political behavior and its resource and/or legitimacy implications

Articles	Approach (Theoretical or Empirical)	Major Arguments
Boddewyn & Brewer, 1994	Theoretical	Examined the political nature of IB and the role of government as a factor of production
Hillman & Hitt, 1999	Theoretical	Studied the process of political strategy formulation
Park & Luo, 2001	Empirical	Chinese companies use guanxi as a strategic mechanism to overcome competitive and resource disadvantages by cooperation and exchange of favours with competitors and government authorities
Child & Tse, 2001	Theoretical	The behavior and strategies of Chinese MNEs are informed by political and economic motives of the Chinese government
McWilliams *et al.*, 2002	Empirical	Extended the RBV argument to show its use to analyze the effectiveness of non-market strategies
Henisz & Zelner, 2005	Theoretical	Cultivating local allies is further enhanced by the legitimacy such partners may provide when incentive alignment among the various partners can be maintained
Hillman & Wan, 2005	Empirical	Institutional factors and the search for legitimacy dictate political strategy
Bonardi et al., 2005	Theoretical	Discussed competition in political markets
Frynas *et al.*, 2006	Theoretical	Discussed the long-term process of acquiring, sustaining, and exploiting firm-specific political resources in international business
Holburn & Bergh, 2008	Theoretical	Discussed strategies firms use to improve the nature of their regulatory environment
Oliver & Holzinger, 2008	Theoretical	Firm's dynamic political management capabilities determine effectiveness of political strategies
Okhmatovskiy, 2010	Empirical	Firms with indirect political ties get access to resources and legitimacy, while avoiding costs associated with political connection
Sun *et al.*, 2009	Empirical	Political affiliation can help a firm access critical physical as well as financial resources
Sun *et al.*, 2010	Empirical	Declining and even negative value of deep political embeddedness by MNE in stable emerging markets
Holburn & Zelner, 2010	Empirical	Organizational capabilities in assessing and managing policy risks developed in home countries of weak institutions helps when investing in host countries with similar institutions.
Forstenlechner & Mellahi, 2011	Empirical	Building legitimacy with the wider community is particularly important in emerging markets
Sun *et al.*, 2011	Theoretical	Identified four political tie archetypes of which none recognized the case of ties created by national governments to facilitate the entry and operations of MNEs in other countries
Doh *et al.*, 2012	Theoretical	Integration of institutional and strategic perspectives would help advance study of non-market strategy, especially in emerging countries
Wang et al., 2012	Empirical	Examines the role of home states in foreign investments
Li et al., 2013	Empirical	Introduces the modified one-tier bargaining model
Duanmu, 2014	Empirical	Examines the influence of home state on expropriation risk
Stevens and Newenham-Kahindi, 2014	Empirical	Explores the value of legitimacy spillover from home states to firms in their foreign operations.

decision makers and opinion makers…." (Boddewyn & Brewer, 1994: 135). In keeping with Dyer & Singh (1998), Boddewyn & Brewer (1994) advanced the notion that critical firm resources figure in the linkages firms maintain with other parties, in this case with governmental parties. However, to the extent that government parties do not directly feature in the market exchanges (at least in capitalist systems) their work expands the scope of such relationships to non-market interactions.

Further refinement and discussion of this idea featured in the non-market strategy literature (Hillman & Hitt, 1999; Holburn and Bergh, 2008; Holburn and Zelner, 2010; Schuler *et al*., 2002) and the IB literature (Frynas, Mellahi, & Pigman, 2006; Sun, Mellahi, & Liu, 2009; Sun *et al*., 2010). Along with these developments, however, came the recognition that political connections may become liabilities and their returns may not justify the associated costs. That is what the empirical evidence of Sun *et al.* (2010) seems to suggest. They found that deep embeddedness in political networks has adverse effects on organizational performance as such embeddedness takes away the ability and willingness to build market-based capabilities. In the absence or lack of such market-based capabilities, organizations may be vulnerable to market dynamics that require application of such capabilities. As well, political connections may become a liability in times of significant changes to government officials. In such events, a firm's prior affiliation may work against the firm. In addition, creation and maintenance of political relationship has associated costs.

The degree to which the attendant liabilities materialize and associated costs accrue depends largely on the nature of the political linkage (Okhmatovskiy, 2010). A direct political linkage takes the form of active involvement of the firm in creating and/or maintaining the connection. In this case, the firm is likely to incur the entire amount of the associated costs and to encounter the total

effects of the potential liabilities. Another way of securing political connections is indirectly through a proxy or proxies. Hillman & Hitt (1999) coined such connection as collective. Collective linkages are likely to reduce the direct risk exposures (Hillman & Hitt, 1999; Okhmatovskiy, 2010).

As well as providing important resource and capability advantages, political connections have potential implications on the pragmatic legitimacy of the organization in consideration. Pragmatic legitimacy is an important sociologic outcome that is central to the resource dependence perspective (Pfeffer and Salancik, 1978; Suchman, 1995). Pragmatic legitimacy is grounded in the self-interested assessment by immediate constituents of the value obtained through exchanges with a party under consideration (Suchman, 1995). Relationships can be useful sources of mechanisms for such legitimacy. Hybels' (1995) definition of legitimacy emphasizes the importance placed on relations:

> Legitimacy is better conceived as both part of the context for exchange and a by-product of exchange [between an organization and its environment]. Legitimacy…exists only as a symbolic representation of the collective evaluation of an institution, as evidenced to both observers and participants perhaps more convincingly by the flow of resources…. (pp. 243).

In addition to emphasizing the place exchanges occupy in legitimacy, the definition highlights the possible linkage between legitimacy and resources. In fact, the resource dependence perspective holds that organizations seek legitimacy as it enables them to have continued access to important resources to a sufficient level as to ensure their survival (Pfeffer and Salancik, 1978). The link between legitimacy and relationships becomes more potent in the case of political relationships (Hillman & Wan, 2005).

The importance of legitimacy is even greater for MNEs whose subsidiaries operate in foreign locations. Acceptance and approval of MNE subsidiaries by stakeholders in the host country is instrumental for their performance (Forstenlechner & Mellahi, 2011). As a result, MNEs employ different strategies to secure host-country legitimacy. Kostova & Zaheer (1999) contend that hiring local employees, especially those who have the potential to confer legitimacy on the subsidiary, would help MNEs secure legitimacy. Another strategy employed by MNEs is to include influential personalities in the host country in the board directorship of the subsidiary (Hillman & Wan, 2005). Similarly, the need for legitimacy may require MNEs to have important political figures as part of their subsidiaries or to partner with the government or other influential parties. Relations between home and host states can also generate legitimacy advantages (Wang *et al*., 2012).

Some home states are more inclined than others to engage in social and personal relations with host-country officials. For example, Chinese officials maintain a strong belief in the cultivation and management such relations to achieve their goals—for example, fostering commercial success of Chinese foreign subsidiaries (Eisenman, 2008; Li *et al*., 2013; Solomon, 1995). Attesting to this notion, Eisenman (2008) noted that between 2006-2008, the communist party of China (CPC) had established ties to at least 60 African political parties, including opposition parties. With the intention of creating stronger social and personal relations, CPC often arranges lavish state visits for the political leaders to develop feelings of goodwill, friendship, and associated obligations (Solomon, 1995).

MNE-DEVELOPING HOST COUNTRY BARGAINING MODELS

A seminal work in the IB literature regarding the relationship between MNEs and developing host countries is that of Vernon (1971). It introduced the *obsolescing bargaining model* that describes the bargaining process between the two parties. Describing the MNE-host country relationship

typical of the 1970's and 80's, the model specifies their bargaining as a function of negotiation and compromises on the goals, resources, and constraints of each party (Eden *et al*., 2004; Ramamurti, 2001; Vernon, 1994). The model suggests that MNEs tend to have a better bargaining position at first, because they have firm specific assets appealing to many host countries, including modern technology. The bargaining power, however, gradually shifts to the host countries once the MNEs make commitments in the forms of fixed assets. As the initial contract expires and when the MNEs want to strike a new deal, they find themselves at a less favorable position because of the difficulty in relocating fixed investments. While the model aptly described the bargaining process especially in the natural resource industries, its application can readily extend also to any investment that requires commitment in the host country of significant fixed assets.

From the 1990's onward, the MNE-developing host state relationships has departed from the obsolescing bargaining model in at least two important ways. First, the spirit of competition underlying the obsolescing bargaining model makes way for more cooperative dealings between the two parties (Eden *et al*., 2004; Ramamurti, 2001). Developing host countries introduced multiple waves of reforms to open their markets, partly through their own initiatives and partly through pressures from home countries and such multilateral institutions as the World Bank, IMF, and WTO (Ramamurti, 2001).

Second, other third parties including home countries and multilateral institutions became increasingly involved in the bargaining process, rendering the bargaining process more complex. One salient aspect of the complexity is the introduction of a level of bargaining between home and host countries or between multilateral institutions and the host countries. This new tier of bargaining, along with the bargaining at the traditional level (i.e., between MNEs and host countries) gave rise to a two-tier bargaining process (Ramamurti, 2001). The introduction of these

third parties was to ensure that MNEs would not suffer from a bargaining power that eventually becomes obsolete. In the *two-tier bargaining model*, tier-one represents bargaining between home countries (sometimes represented by multilateral institutions such as IMF and the World Bank) and host countries. Tier-one bargaining involves bilateral or multilateral negotiations on strategic issues of entry, market liberalization, and structural adjustments by host countries. In return, host countries receive development assistance often in the form of loans. The tier-one bargaining is to pave the way for tier-two bargaining between MNEs, affiliated to the home country or the multilateral institution, and the target host country. The tier-two bargaining focuses more on operational issues and carries much less significance than in the traditional obsolescing bargaining model as host governments have their bargaining positions weakened in tier-one bargaining (Ramamurti, 2001).

The two-tier bargaining augments the bargaining power of MNEs because powerful home countries and/or multilateral institutions are on their side. As a result, the tendency for the bargaining power of the MNEs to become obsolete is highly unlikely, as even when the MNEs have committed considerable fixed assets, the presence in the background of such powerful supporters preserves the bargaining power with the MNEs. While this bargaining model contributed to the remarkable decrease in expropriation of subsidiaries by developing country governments, it had also deprived government in developing countries of their ability to protect their rights and secure equitable distribution of gains. Even when there is clear evidence that MNEs are involved in a high-profile transfer pricing activity in which they transfer their profits to subsidiaries located in tax havens, the host governments have but limited latitude to influence the behaviors of the MNEs (Eden & Rodriguez, 2004). Ramamurti (2001) observed that any action by the host government to clamp down on such behavior may be interpreted as aggression and the

home countries can impose crippling economic sanctions on the developing host countries. As well, bilateral and multilateral treaties as well as customary international law provide protections against adverse actions by host countries (Dolzer and Schreuer, 2008).

Similarly, provision of loans or cancellation of debts for developing host countries further weakened their bargaining power, limiting their ability to strike favorable deals with MNEs. In exchange for these loan provisions or debt cancellations, host country governments are required to meet the demands of the home countries, thereby ceding power to the MNEs from these countries. Further undermining the bargaining positions of developing host countries is the competition among many developing countries to attract inward FDI (Eden & Lenway, 2001). Such competition may entail use of generous subsidies and tax holidays. In general, this bargaining model makes for the maximization of MNEs' returns, while reducing the share of host countries.

Likewise, Eden *et al*., (2004) argued that the entry and obsolescing conditions underlying the obsolescing bargaining model are no longer applicable to the bargaining relationship between developing states and MNEs. They advanced a *political bargaining model* which suggests involvement of different parties including governments and MNEs negotiating on wide array of government policies. This model is consistent with the two-tier bargaining model in that the problem of the obsolescing bargaining power of MNEs is resolved by the introduction of third parties such as home governments to maintain the better bargaining positions of the MNEs. Similarly, most bargaining on entry conditions is either settled at the tier-one bargaining stage or is rendered irrelevant as host countries are pitted against each other to attract FDI and take their own initiative to lure MNEs.

Nebus & Rufin (2010) attempted to extend the bargaining power paradigm into what they called the *network bargaining model.* Integrating insights from network theory, the model captures the

complexity of the environment in which bargaining takes place and the diversity of the actors involved in it. Particularly, the authors argued that MNE operation in host countries is a result of bargaining among state governments, multilateral organizations, MNEs and NGOs. As well, the model conceptualizes the bargaining process as being influenced by the power dynamics and interplay between or among these parties.

Aside from the introduction of NGOs as relevant parties in the bargaining process and the integration of the network theory with the bargaining theory, the view advanced by Nebus & Rufin (2010) is fundamentally in line with those of the political bargaining model and the two-tier bargaining model. Central to each model is the notion that bargaining is not dyadic but involves parties other than MNEs and host-country government. Further, each model suggests that bargaining has multiple spatial dimensions, taking place at different levels and contexts and addressing different aspects of the bargaining results.

A recent work by Li *et al*. (2013), however, pointed to the presence of a different form of bargaining model, with different structures and potential implications. In their study of outward investment of Chinese companies in Africa, especially those investing in the natural resources industry, the authors identified a bargaining model, which is different from the one used by the advanced economies. The Chinese model involves the home government directly negotiating deals with each host government on behalf of a consortium of investors. These investors get financial and infrastructural backing from the Chinese government. As well, the Chinese government works closely with potential host countries to identify opportunities for its affiliated firms. In this model, unlike in the two-tier bargaining model used by most advanced economies, the home government plays a more active role and works more closely with host governments to create favorable investment opportunities.

The dealing of the Chinese government differs from the two-tier bargaining model in three important ways. First, the Chinese government, unlike the governments of the advanced economies, deals with both the strategic issues of creating favorable investment host-country climate and the operational issues of identifying opportunities and facilitating the actual entry and operation of Chinese investors in the host country. In the case of the two-tier bargaining model, home country governments assume a limited role of facilitating the creation of favorable investment climate. Bargaining on operational issues is considered the responsibility of the MNEs.

Second, the MNEs represented by the Chinese government are not required to engage in direct talks and relationships with the host governments; instead, they act as 'ambassadors' of the Chinese governments. Once a deal is brokered between the Chinese government and a host country and once a viable host-country opportunity is identified, these Chinese MNEs will invest in the host country and start operations. MNEs entering through the two-tier bargaining model need to directly interact with the host-country government; Chinese MNEs, however, have indirect relations with the host-country government. It should be noted, however, that indirect political connection can involve any third party conducting the entire political negotiation on behalf of the principal(s) (i.e., MNE(s)). This research considers one form of indirect political connection in which the third party is the home government (i.e. Chinese government).

Third, the bargaining between Chinese governments and developing host-country governments has more to offer to the host-countries than is possible through the two-tier bargaining model. The bargaining spirit is more cooperative in that host countries, in return for creating a favorable investment climate and facilitating identification of local opportunities, receive development assistance in the form of infrastructural construction, low interest loans, and outright grants. Generally, since the bargaining model for the entry of Chinese MNEs involves bargaining between

the home government and host government, Li *et al*., (2013) called it the *modified one-tier bargaining model,* suggesting the similarity of this model to the traditional one-tier bargaining model (i.e., the obsolescing bargaining model). Table 12 provides a summarized description of the different bargaining models.

TYPOLOGY OF POLITICAL CONNECTIONS

To theorize about the performance implications of the modified one-tier bargaining model, this research draws on Hillman & Hitt's (1999) arguments on the nature of political connections. They developed two important sets of arguments regarding the nature of political ties. The first involves the classification of political connections as transactional and relational. The transactional approach entails building relationships on specific issues perceived as important by the firm under consideration. It has a relatively short-term orientation, and during the planning of the transactional approach, emphasis is laid on the substance of the exchanges between the parties. In contrast, the relational approach requires building relations across multiple issues and over time. It has a more long-term orientation, and crafting a relational approach requires emphasis on the structure and process of the relationships. It can be argued that the modified one-tier bargaining model follows the relational approach. Active involvement of the Chinese government in host-country infrastructural development and the joint involvement of the Chinese government and host governments in identifying investment opportunities (Li *et al*., 2013) are indicative of the relational nature of the modified one-tier bargaining model.

Table 12: Comparison of the bargaining models for inward FDI to developing countries

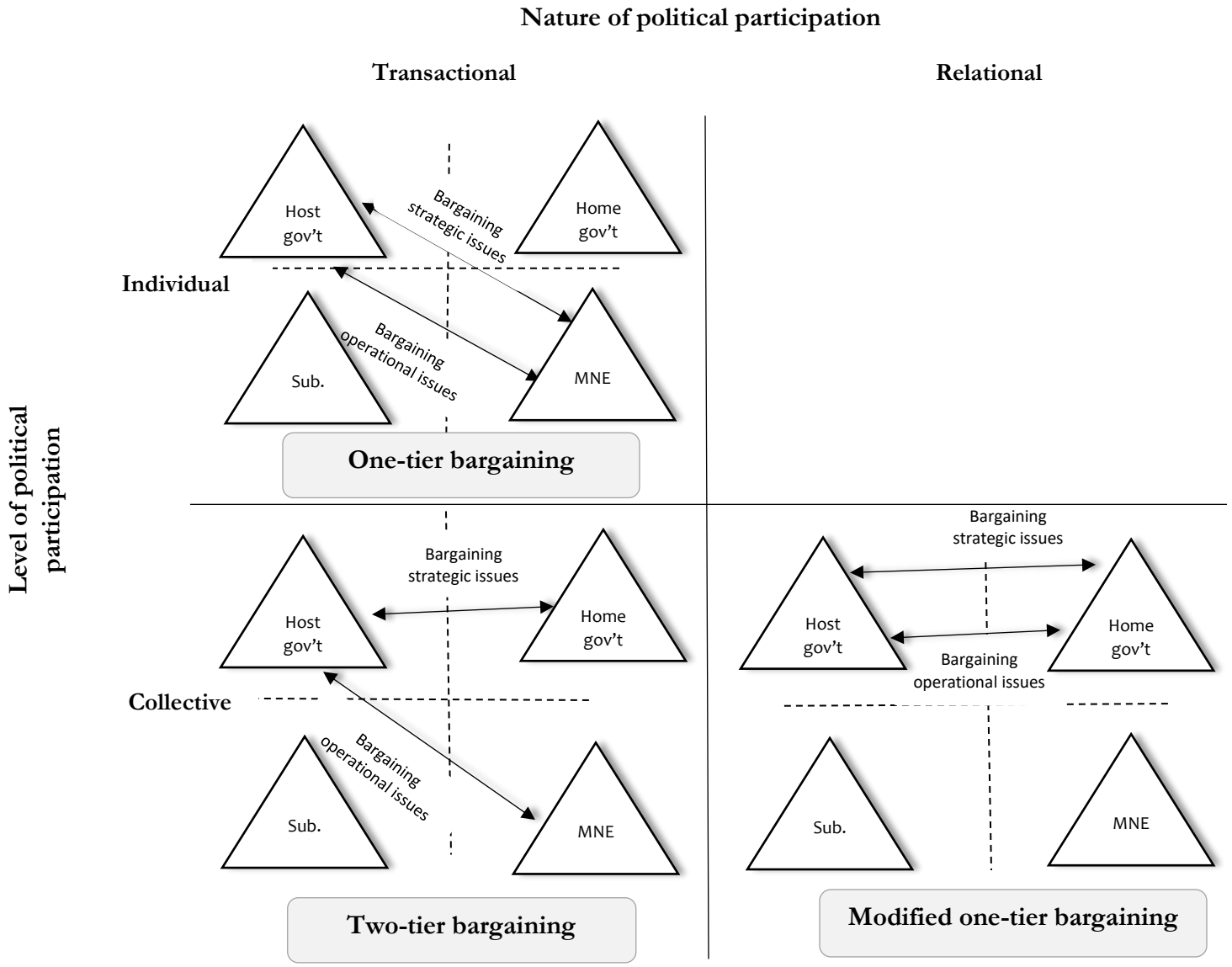
	One-tier bargaining	Modified one-tier bargaining	Two-tier bargaining
Forms of bargaining	State to MNE (i.e., host state to MNE)	State to state (i.e., home country to host country)	State to state (i.e., home country to host country)- tier-one AND State to MNE (i.e., host state to MNE)- tier-two
Relationship with host government	Mostly transactional	Relational	Transactional
Parties involved	Host government and MNE	Home and host governments	Home government, multi-lateral parties (e.g., IMF, World Bank), host government, and MNE
Exchanges	Host state - opens up market - Incentives such as subsidies and tax holidays MNE – Tax revenues and firm specific resources such as technology and financial resources	Host state -opens up market -Incentives such as subsidies and tax holidays; mutually identifying investment opportunities[a] Home state - Financial and technical support for host country infrastructure development[a]; low interest loans and outright grants to host country	Host state - opens up market - Incentives such as subsidies and tax holidays Home state - loans Multilateral institutions- loans MNE – Tax revenues and firm specific resources such as technology and financial resources
Issues bargained	Both strategic and operational issues of investment at tier-two	Both strategic and operational issues of investment at tier-one	Strategic issues at tier-one and operational issues at tier-two
Used by	Early Western MNEs in developing countries	Chinese SOMNEs in developing countries	Western MNEs in developing countries
Status of political relations of the MNE	Individual-The MNE needs to create direct political connection	Collective-Indirect political connection through the home country	Individual-The MNE needs to create direct political connection
Costs/benefits to the MNE	Direct costs need to be incurred to generate direct benefits	No direct costs incurred, but direct benefits are generated	Direct costs need to be incurred to generate direct benefits
Social capital to the MNE	Direct costs need to be incurred to secure social capital	Trickles down from home state legitimacy; thus, no direct cost by the MNE to secure social capital	Direct costs need to be incurred to secure social capital

[a] elements of the bargaining that define its relational nature

The second set of arguments concerns the parties involved in creating the political connection. Drawing on earlier works in political science, Hillman & Hitt (1999) theorized about political connections created through individual and collective actions. Connections through individual actions entail direct linkages and load the entire political cost on the participating firm. Connections through collective actions, in contrast, involve indirect linkage via third parties such as trade associations. Not only does such a linkage secure greater economies of scale, it facilitates sharing of political costs among members, thereby requiring lower direct expenditure by the target firm. The study contends that inherent in the modified one-tier bargaining model is the collective approach to political connections, with its attendant benefits.

Integrating arguments on the two aspects of political connections, this study submits that the modified one-tier bargaining model is an empirical illustration of the collective-relational approach to political connection. As presented in Table 13, political connections to developing host countries may take any of the four types grouped into four quadrants, depending on the combination of the general approach (i.e., transactional or relational) and the level of participation (i.e., individual action or collective action) used. Quadrant-1 represents relational connections created directly by an individual firm. A direct long-term relationship created by an MNE with a host-country government falls into the individual-relational political connection presented in quadrant-1. Quadrant-2 and Quadrant-3 represent transactional approaches to political connections created through individual actions and collective actions respectively. The two-tier bargaining used by most advanced countries is shown in Quadrant 3. Quadrant-4, on the other hand, entails a collective-relational relationship, which involves long-term, multi-issue relationships formed by a collective unit (e.g., the Chinese government) on behalf of individual firms (e.g., Chinese MNEs).

Table 13: A typology of political connections with developing host states



The Collective Approach

The Chinese government follows a hands-on approach in its bargaining with host developing countries. Through intensive political coordination with host governments, the Chinese government seeks to put its MNEs in better positions. Here, the study argues that the collective nature of the modified one-tier bargaining model provides resource and capability endowments that in turn offer competitive advantage to the MNEs and their subsidiaries in host countries. The collective approach of political connection enables the affiliated subsidiaries to access resources without incurring direct costs and to focus on developing market-based capabilities free of political distractions.

Inherent in the design of the modified one-tier bargaining model are the potential advantages Chinese MNEs and their subsidiaries get because of their association with the home and host governments. The arrangement and the unique form of tie with host governments make it possible for the Chinese subsidiaries to access useful pieces of information on government policies. Clearly, such information has considerable value in anticipating changes in the policy environment and reducing political uncertainty (Hillman & Hitt, 1999). In fact, literature in IB as well as in non-market strategy holds that interactions between businesses and government can be construed as a political market exchange in which business firms ‘procure’ vital information and policy favors (Boddewyn, 2016; Bonardi *et al*., 2005; Hillman & Keim, 1995). As a result, by reducing the cost of critical information and helping subsidiaries better coordinate their activities in light of ex ante information, the collective nature of the modified one-tier bargaining model can contribute positively to the competitive advantage of the Chinese subsidiaries.

Similarly, by virtue of their relationships with the home and host governments, MNEs and their subsidiaries can have better access to financial resources, in the form of either access to loans or

outright grants. The Chinese MNEs, because of their affiliation with the home government, receive financial backing (Li *et al*., 2013; Luo & Tung, 2007). Further, because of their indirect linkage with the host government, they are also entitled to privileged treatments in the form of subsidies and other special incentives. The combined effect of these advantages is likely to offer competitive advantages to the Chinese subsidiaries.

Another important aspect of the modified one-tier bargaining model is the development assistance provided by the Chinese government on infrastructural building. A major challenge facing foreign MNEs operating in developing countries is infrastructure. Indeed, implicit in the higher operational risk associated with investing in developing countries is the challenges resulting from weak or inexistent infrastructure (Doh & Ramamurti, 2003). To mitigate such infrastructural challenges, organizations may need to incur additional expenses or devise alternative mechanism which may require investment of different sorts. The assistance for infrastructural development offered collectively by the Chinese government, whose interests are aligned with its MNEs, provides the opportunity to synchronize infrastructural development with the present and future investment directions of the MNEs (Sun, Mellahi, & Wright, 2011). Clearly, such synchronization will likely have a positive implication for the competitive advantage of the subsidiaries. Further, such a wide-scale of assistance is unlikely to be imitated by other states or organizations, leading to the following proposition.

> *Proposition 1: Foreign subsidiaries whose MNEs draw on the collective approach to political relations with developing host-country governments are more likely to achieve greater competitive advantage than those using the individual approach.*

The Relational Approach

The relational approach to political action has favorable legitimacy and social capital implications (Hillman & Hitt, 1999). This approach confers legitimacy upon the parties involved as well as their affiliates. In this case, these parties include the Chinese government and the consortium of MNEs it represents. Legitimacy assumes an even greater significance when investing in a foreign territory. Challenging foreign markets, such as those in developing countries, demand that MNEs achieve economic efficiency as well as legitimacy to become successful (Chan, Isobe, & Makino, 2008; Kostova & Roth, 2002). Legitimacy of an MNE in a foreign country provides a mechanism to overcome the liability of foreignness and grants a social license to operate (Kostova, and Roth, 2003).

One major source of gaining such important legitimacy is by having long-term oriented working relationships with the host country government, which is assumed to represent the interests of the society in that country (Hillman & Wan, 2005). The relational approach inherent in the modified one-tier bargaining model provides the affiliated subsidiaries with legitimacy advantage. Owing to the special arrangement in place by the modified one-tier bargaining model, Chinese subsidiaries can gain legitimacy more than what a normal political tie is likely to provide. Such gain results from the relationship maintained by the Chinese government on a wide-array of issues, addressing host country interests on multiple fronts.

The potential for obtaining and maintaining legitimacy through such a bargaining model is high in most developing countries where government officials wield considerable power and control in the formulation of policies and regulations pertinent to inward MNE investments. Acquaah (2007), for example, describes the value of political connections by explicating the substantial role played by Ghanaian government officials in controlling financial institutions, awarding major contracts,

and defining regulatory and licensing procedures. The CPC, with its distinctive negotiating behavior that relies heavily on developing strong interpersonal relationships with foreign officials, cultivates ties with these influential parties (Solomon, 1995).

While government is a useful source of legitimacy, it may not give rise to social capital from other local constituents. In fact, legitimacy in each host country is a function of a goodwill not just from the host government but also from other stakeholders with which a foreign subsidiary interacts in its local operations (Suchman, 1995). The study argues that the development assistance the Chinese government offers as part of the bargaining model consolidates the relational status of political connection between home and host governments. That is, the reputation built for the Chinese MNEs, because of visible impact on infrastructure and agricultural sector, is likely to increase the popular legitimacy of China and by extension of its national subsidiaries. This argument is consistent with the suggestion by Forstenlechner & Mellahi (2011) that building goodwill with the wider community is key, especially when operating in emerging countries.

Proposition 2: Foreign subsidiaries whose MNEs draw on the relational approach to political connections with developing host-country governments are more likely to achieve greater social capital than those using the transactional approach.

The Collective-relational Approach

That relationships are important sources of resources and capabilities is widely acknowledged (Dyer & Singh, 1998). As with market relationships, non-market relationships, of which political relationships are a type, provide benefits with important performance implications. In addition, political resources are frequently in short supply and difficult to be copied by competitors (Boddewyn & Brewer, 1994). Access to political figures is often limited and creating and maintaining political ties requires, among other things, experience (and capability) in dealing with political decision makers (Frynas *et al*., 2006). Invisibility and associated causal ambiguity makes

political resources difficult to imitate, thus serving as a useful source of competitive advantage (Lippman & Rumelt, 1982).

Particularly, the scale of political connection (because of the collective approach) and the level of benefits channeled to host country governments (because of the relational approach) in the modified one-tier bargaining model make it practically impossible for Western MNEs as well as their governments to remain competitive. Given that neither Western MNEs nor their home governments appear likely to match the scale and scope of support rendered by the Chinese government, it is reasonable to expect that Chinese subsidiaries will have enduring host country preferential treatment. As well, the CPC demonstrates a greater level of commitment to building strong relations with key host-country government officials than its western counterparts. A telling account of Chinese distinctive approach to such ties features in Eisenman (2008):

> "…While delegations looking to visit the United States…are subjected to an endless array of security procedures and red tape, Beijing has simplified procedures and supported delegations led by African political leaders. One former African ambassador to China recounted his own experience: 'when I was arriving at my post, I was scheduled for a brief meeting and photo with President and CPC Chairman Jiang Zemin. Instead, we spoke for nearly an hour. President Jiang not only had a broad continental view of Africa, but I was also very impressed with his detailed knowledge of African issues and how close they were to his heart.'," (p. 236).

Empirical evidence abounds on the positive influence of political ties on organizational competitiveness and performance (e.g., Frynas *et al*., 2006; Hillman, 2005). However, an equally convincing body of literature shows the downsides of creating and maintaining political connections (e.g., Okhmatovskiy, 2010; Sun *et al*., 2010). The study argues that looking at the different types of political ties can help us appreciate the finer nuances in the relationships between political relations and firm competitiveness. The typology of political connections advanced here represents an attempt to understand these nuances. Such consideration can potentially help explain

the mixed results besetting this line of inquiry. It can, therefore, be argued that the indirect linkage Chinese MNEs and their subsidiaries have with the host government enables them to focus more on their core functions, while benefiting from spillover legitimacy resulting from their government's political coordination and involvement in host country development activities.

> *Proposition 3: Foreign subsidiaries whose MNEs draw on the collective-relational approach to political connections with developing host-country governments are more likely to achieve greater competitive advantage than those using the collective-transactional, individual-transactional, or individual-relational approaches.*

Investment Motive as Boundary Condition

Foreign direct investment by MNEs arise from the need to achieve a given investment motive(s). These motives define the rationale for which the investment was made and undergird pertinent strategy formulation and decision processes. Four major motives drive firms' engagement in foreign value-adding activities in developing countries: market-seeking, resource-seeking, efficiency-seeking, and strategic assets seeking (Dunning, 1998). The motive(s) underlying MNEs' foreign direct investments is (are) likely to have structural as well as strategic implications for the foreign subsidiaries. For example, structurally, a market-seeking subsidiary is much less integrated with its parent MNE as well as its sister subsidiaries. Strategically, it is more focused on host-country markets (Slangen and Beugelsdijk, 2010; Getachew and Beamish, 2017). In contrast, resource-seeking subsidiaries are vertically integrated extensions of their parent MNE. As such, they have a strategically important role in their respective MNE's global value chain (Nachum and Zaheer, 2005). The key role such subsidiaries play in their parent network and their desire to access host-country resources, which the host government may consider strategic, are likely to result in different dynamics to the MNE-host country bargaining process.

A resource-seeking subsidiary is principally concerned with accessing useful resources that are not available in the home country of the investing firm, or are available at higher cost than could be obtained in the selected host country (Dunning, 1998). Foreign subsidiaries whose prime purpose is to access host-country natural resources and raw materials, which are immobile or costly to transport, represent ideal examples of such subsidiaries. Bargaining in the case of resource-seeking investments is likely to be complicated for at least three reasons. First, resource-seeking subsidiaries often play an integral part in the global value-chain of their parent MNE, with key contributions to sister subsidiaries as well. With this key role such subsidiaries play comes a greater dependence of their respective MNEs on these subsidiaries and thus a greater need to establish their continued operation. Such dependence is likely to undermine the MNEs bargaining power over the host government (Fagre and Wells, 1982; Pfeffer and Salancik, 1978).

Second, resource-seeking investments tend to be much larger and less mobile than other kinds of investments such as those which are market-seeking (Nachum and Zaheer, 2005). As well, assets of resource-seeking subsidiaries are less fungible (or have greater asset specificity) and thus are less likely to be redeployed elsewhere (Anand and Singh, 1997; Dunning and Lundan, 2008; Williamson, 1985). As a result, MNEs with resource-seeking investments in a given host country tend to exercise lower bargaining power in their dealing with host government. Third, resource-seeking investments carry greater policy/regulation risks because of the considerable strategic importance developing host countries attach to (natural) resources, the politically sensitive nature of resource use by foreign agents, and the negative externalities (for example, environmental degradation) associated with resource extraction (Dunning and Lundan, 2008; Eden *et al*., 2004; Vernon, 1971). Therefore, an MNE employing an individual and/or transactional bargaining model is likely to suffer the consequences of a weaker bargaining power coupled with greater

policy/regulation risks. In contrast, an MNE using a collective-relational bargaining model is likely to command a better bargaining stand. A telling example is that of Chinese government, which not only has propelled Chinese MNEs to invest in gold mining in Ghana but also has reportedly managed to exert pressure on the Ghanaian government to allow firms to bypass local regulations (UNCTAD, 2007). This leads to the following proposition:

> *Proposition 4: The relationship between the use of the collective-relational approach to political connection and competitive advantage is stronger for a resource-seeking investment of MNEs such that, for investments of this kind, the collective-relational approach is more likely to lead to a greater competitive advantage than the collective-transactional, individual-transactional, or individual-relational approaches.*

Institutional voids as Boundary Condition

Institutional voids characterize economic markets of developing host countries and are largely responsible for the greater level of uncertainty MNEs encounter when operating in these countries (North, 1991; Wright *et al*., 2005; Xu & Meyer, 2012). Three main challenges beset transformations and transactions in locations of high institutional voids: limited access to quality information, regulations that limit scale and/or scope of business operations, and issues in enforcement of contracts and protection of property rights. As well, the absence/lack of such institutional arrangements provide corrupt politicians with an opportunity to exploit firms for their private benefits. All these undermine the efficiency of MNEs while also subjecting them to greater uncertainty.

Firms use political connection to mitigate the dual hazards of inefficiency and uncertainty (Inoue, Lazzarini, and Musacchio, 2013; Musacchio, Lazzarini, and Aguilera, 2015; Park and Luo, 2001). By nurturing and leveraging long-term reciprocal formal and informal ties with host-country governments, firms economize on transaction as well as transformation costs. Firms with such ties

are likely to gain better access to key resources and information, thus benefiting from potential improvements in efficiency and/or reduced uncertainty in the political and regulatory environment (Gargiulo and Benassi, 2000). Political connections also help in safeguarding property rights and mitigating contractual hazards (Luo *et al*., 2010). In fact, in locations of high institutional voids, politically connected firms tend to outperform their counterparts (Brockman *et al*., 2013).

To mitigate challenges in property right protection, contract enforcement, and information availability, firms form political connections. However, the value of political connection as a substitute for weak economic institution is likely to decline as these institutions develop (Brockman *et al*., 2013; Musacchio *et al*., 2015). Development in economic institutions can render such political connection less useful and relevant. With improvements in economic institutions, the appeal of the collective-relational bargaining model is likely to diminish for two main reasons. First, developing institutions undermine the potential to get political rents through political ties and instead emphasize the need to secure market-based capabilities and efficiencies. Foreign subsidiaries drawing on the collective-relational bargaining model are often hybrids with dual objectives (i.e., economic and political objectives) (Cuervo-Cazurra *et al*., 2014; Deng, 2009). As a business entity, these subsidiaries seek to secure economic returns (i.e., profits). However, by dint of their collective affiliation (i.e., affiliation to the home state), they intend to achieve the political interests of their home government. For example, some of the Chinese state-owned MNEs (SOMNEs) which are operating in the African infrastructure and mining sectors are designed to satisfy both commercial and non-commercial purposes. Specifically, they are designed to increase the Chinese government's influence in the continent, and foster partnerships between the Chinese government and the host governments (Cuervo-Cazurra *et al*., 2014). Such dual objectives can undermine the focus of the subsidiary and harm its market competitiveness. This is

likely to be truer in circumstances when developing economic institutions reduce the value of political rents.

Second, the collective-relational bargaining model, which features direct involvement of the home country in the bargaining process, is likely to generate concerns of sovereignty breach and extraterritoriality. In fact, in most developing countries, there is a tendency to consider foreign subsidiaries as extensions of imperialistic rule (Chironga *et al.,* 2011). With direct and active involvement of the home country, it is likely that such concerns will be even more intense. SOMNEs, which by design draw on the collective approach to bargaining, tend to be perceived as threats to the host's national security because of their apparent ties with their home country (Globerman & Shapiro, 2009) and are likely to suffer competitive disadvantages in attracting local customers (Cui & Jiang, 2012). The adverse effects of such concerns are likely to be more salient as economic institutions develop and market competition intensifies—developments that may undermine the upsides of political connections. The foregoing arguments, therefore, lead to the following proposition:

> *Proposition 5: Development of economic institutions in the host country attenuates the positive relationship between the use of the collective-relational approach to political connection and competitive advantage. As economic institutions develop, the use of the collective-relational approach is less likely to secure competitive advantage.*

Political Institutions as Boundary Condition

By defining expectations and rules, host-country political institutions substantially influence the strategy and performance of foreign subsidiaries (Henisz, 2000; March and Olson, 1996; North, 1991). Whereas political institutions constitute various aspects of shared meanings and practices that shape the actions and organization of political actors (including states and business organizations), a prime representation of political institutions exists in the governing mechanism

underlying the political system of the country (i.e., democratic or autocratic) (Li and Resnick, 2003). Although consensus has yet to be arrived on what constitutes democratic institutions, they include:

> "…government based on majority rule and the consent of the governed, the existence of free and fair elections, the protection of minorities and respect for basic human rights. Democracy presupposes equality before the law, due process and political pluralism," (*The Economist*, 2007).

Developments in democratic institutions have potential implications for the effectiveness of the collective-relational approach to political connection in at least two respects. First, such developments undercut the advantage MNE subsidiaries obtain from the strong partnership (or collusion) between the home and host governments. The nature of the principal-agent relationship between host government and the society it governs in the presence of democratic institutions is considerably different from when they are absent. Whereas, in general, autocratic political systems are characterized by potential asymmetry between the interests of government officials and that of the people, democratic political systems are better at aligning the interests of the two parties (Huber and Powell, 1994; Li and Resnick, 2003). Democratic institutions place constraints upon government officials and restrict their ability to grant special favours and prevent them from engaging in predatory rent seeking (Feng, 2001). Similarly, freedom of expression and free media characterizing democratic political systems promote better monitoring of elected officials and allow local stakeholders to have greater voice in policy formulations. These, therefore, limit the potential for the collective-relational approach to generate competitive advantage as well as political rents to foreign subsidiaries.

Second, as well as limiting the rent-seeking benefits accruing to foreign subsidiaries through the collective-relational approach, democratic institutions provide mechanisms for credible property

right protection and contract enforcement (Feng, 2001; Olson, 1993; Pastor and Sung, 1995). The associated risks which foreign subsidiaries face in democratic political systems, therefore, are less than that in autocratic systems. One of the main reasons for political connection by MNEs in developing countries is to access a substituting mechanism for a better protection of property rights and enforcement of contracts. Ties to government officials can provide the needed buffer from property right and contractual hazards (Zheng, Singh, and Mitchell, 2014). By providing alternative and less costly mechanisms, democratic institutions render the return to political connection inconsequential. The foregoing arguments, therefore, lead to the following proposition and Figure 7 shows the entire theoretical model:

> *Proposition 6: Development of democratic institutions in the host country attenuates the positive relationship between the use of the collective-relational approach to political connection and competitive advantage. As democratic institutions develop, the use of the collective-relational approach is less likely to secure competitive advantage.*

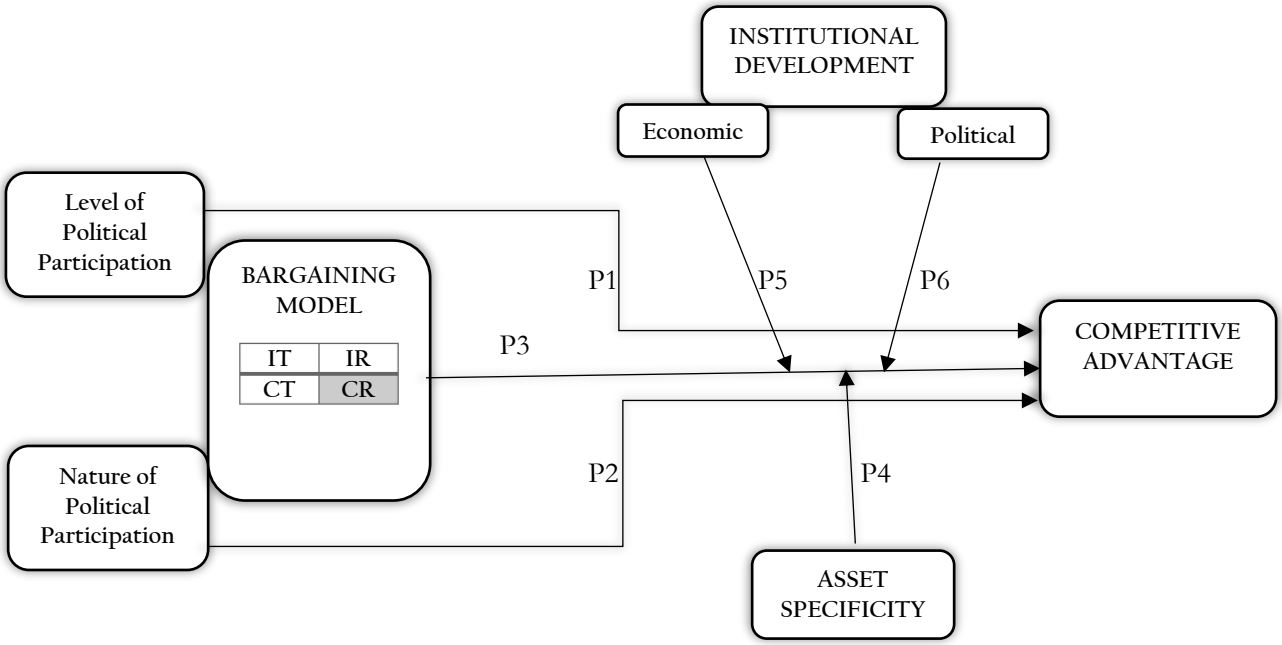


Figure 7. Theoretical model of the research

DISCUSSION AND CONCLUSION

High institutional voids characterizing developing countries give rise to economizing challenges as well as strategizing benefits (Getachew and Beamish, 2017; Williamson, 1991). In such countries, MNEs often put in place strategies to mitigate economizing challenges and/or leverage strategizing benefits. Forging political connection with host-country government officials is one such strategy that may help tap strategizing advantages as well as attenuate economizing challenges arising from poor property right protection and contract enforcement as well as from limited access to useful, timely information. However, there are different approaches to political connections and not all political connections are equally effective in securing strategic advantages and/or reducing economizing challenges. By considering several approaches to political connection (i.e., bargaining models), this study seeks to develop a better understanding of the attributes and implications of different approaches to structure the relationship between MNEs and respective host countries. This study attempts to theorize about the different forms of political

connections in international business. In doing so, it draws on insights from prior literature that discusses political connections across the basic approach followed (i.e., transactional vs. relational) and the locus of action (i.e., individual vs. collective). It grounded its theorization in an illustration of the different kinds of bargaining model supporting foreign direct investments in developing countries. Specifically, it advance the notion that the collective-relational approach to political connections is likely to afford foreign subsidiaries a better competitive advantage when operating in developing countries. This approach often involves an active role of the home-country government in bargaining both strategic and operational issues on behalf of the MNEs hailing from the same country. For example, investment of Chinese SOMNEs in Africa leverages the collective-relational approach to political connection and consequently reaps the benefits of the strategizing advantages set at their disposal (Cuervo-Cazurra *et al*., 2014; Li *et al*., 2013; Luo *et al*. 2010; UNCTAD, 2007).

Prior evidence on the performance implications of political connections is mixed at best. One potential approach to resolving such empirical challenge is by disaggregating political connection to its different formats. This paper does just that. By classifying political connections across the level and nature of political participation, it identifies four different typologies of political connection. The study positioned its theoretical arguments about these different types of political connection in the bargaining models characterizing foreign investment of MNEs in developing countries. In doing so, it not only engages the issue of political connection in the context of international business but it also grounds its theorization in the unique realities of developing countries where host states are more active and political connections more important. These different approaches to political connections reflect the different ways through which MNEs from different backgrounds (i.e., MNEs from advanced vs. emerging markets) seek to gain strategizing

advantages through political connections. As such, on a broader level, the theorization can contribute to a better understanding of the differences in the fundamental assumptions and strategy governing foreign direct investment of MNEs with disparate backgrounds.

The typology identified to classify different kinds of bargaining models can be considered governance structures used to structure political exchanges between MNEs and their respective host governments. The notion of governance is central to the transaction cost economics in which different types of governance structures—namely, market, hierarchy, and hybrid—used to structure economic exchanges (e.g., Williamson, 2010). This paper attempted to extend this notion of governance to political exchanges in which MNEs and their host government engage in recurrent bargains on strategic and operational issues. The four different approaches identified can be considered alternative governance structures, providing the foundation on which political exchanges take place. The theoretical argument suggests that the collective-relational governance structure is likely to offer superior value in terms of competitive advantage for foreign subsidiaries operating in developing countries, ceteris paribus. Future research in this area can draw on the transaction cost politics (TCP) arguments to further refine our understanding of the nature as well as implications of these governance structures (Henisz and Zelner, 2005; North, 1991).

By identifying and theoretically examining potential boundary conditions, this study further refined understanding of the relationship between the type of governance structures employed and the competitive advantage of foreign subsidiaries leveraging these structures. It extended the transaction cost logics regarding asset specificity and governance structure to political exchanges and argued that the effectiveness of the collective-relational approach becomes stronger for resource-seeking investments—investment with greater asset specificity and thus less likely to be redeployed elsewhere (Anand and Singh, 1997; Dunning and Lundan, 2008; Williamson, 1985).

It also puts forward arguments suggesting that developments in host-country economic as well as political institutions provide alternative mechanisms for MNEs to mitigate economizing challenges, rendering political connections somewhat redundant and less useful. Also, the theoretical arguments suggest that the influence of the bargaining model on competitive advantage is through improved resource/capability mobilization and social capital. By highlighting the intermediate mechanisms at work in the relationship of political ties and competitive advantage, this work provided an important theoretical connection.

As well, this study extends theoretical discussions on several streams of inquiry. First, it provides additional support to arguments in strategy research that emerging market MNEs have different strategic orientations and studying these MNEs can generate useful insights for our existing theories (Hoskisson *et al*., 2000; Wright *et al*., 2005; Xu & Meyer, 2012). Second, it contributes to a better understanding of the business environment in developing countries and supports the idea that such countries have unique features worthy of further exploration (Wright *et al*., 2005; Xu & Meyer, 2012). Third, the collective-relational approach introduced here uncovered the complementary nature of resource mobilization and legitimacy as explanations of competitive advantage. As such, this study has not only integrated perspectives from the RBV and the resource dependence perspective but also highlighted the value of doing so. Finally, it examined political connections, an important area in IB research, and points to the merits of considering non-market forces when dealing with MNE and subsidiary performance.

Regarding practice, the theory developed in this study indicates that the collective-relational bargaining model—in which political connection in the host country involves an active collective actor (e.g., home state)—is likely to be more effective for MNE managers in securing better competitive advantage when operating in developing countries. This is especially true for

investments of a resource-seeking nature such as in mining and oil exploration. However, the effectiveness of the bargaining model is contingent on the development of economic as well as political institutions. That is, as host-country economic and/or political institutions develop, the extent to which the collective-relational bargaining model affords competitive advantage declines. Therefore, such bargaining model is likely to be most effective in less democratic (or more autocratic) developing countries with high levels of institutional voids. These dynamics suggests that the use by managers (or home states) of the collective-relational bargaining model needs to be informed by a thorough examination of both the current levels of economic and/or political institutions, and a clear understanding of how such institutions are likely to change going forward.

In conclusion, this study encourages future research to further explore the relationships between market outcomes and non-market forces. By closely studying the roles of government-business interaction, such research can make important inroads regarding our understanding of the mechanisms through which social and business interests can be aligned. Also, the theoretical arguments forwarded in this paper need to be subjected to rigorous empirical testing. By doing so, future research will no doubt advance development of fine-grained insights about the relationships discussed herein as well as the mechanisms at work.

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CHAPTER FIVE

GENERAL CONCLUSIONS

In recent decades, scholars in IB and strategic management have devoted a great deal of attention to understanding developing country contexts and their strategic as well as performance implications for businesses operating there (e.g., Beamish, 1985; Hoskisson, Eden, Lau, and Wright, 2000; Vernon, 1971). A salient feature of these contexts is the high level of institutional voids representing the lack or absence of market-supporting institutions (Mair and Marti, 2009). Insights from the new institutional economics (NIE) substantially inform our understanding of institutional voids as well as their strategic and performance implications (Williamson, 2000; North, 1991; Santangelo and Meyer, 2011). Per this perspective, institutional voids engender increased transaction costs in enforcing contracts, protecting property rights, and accessing information.

In contrast, research in industrial organization theory suggests that institutional voids can contribute to a rather easier creation of market power by MNEs, which possess firm-specific advantage (Porter, 1981). Therefore, a more complete understanding of institutional voids and their implications for foreign subsidiaries requires engaging both the transaction-cost (economic) and market power (strategic) implications. This dissertation, therefore, has addressed two sets of research questions: (a) Whether, how, and when host-country market and institutional conditions have implications for the performance of foreign subsidiaries? And (b) Whether, how, and when investment purposes/motives for which foreign subsidiaries are established relate to the extent to which the subsidiaries/their parents overcome the hazards of or capitalize on the opportunities from operating in locations of high institutional voids?

Essay 1 (Chapter 2) draws on insights from NIE and industrial organization theory to examine the economic and strategic implications of entry to the African market. As well, by leveraging insights from the investment motives literature (e.g., Dunning, 1998; Nachum and Zaheer, 2005) and the subsidiary mandate/charter literature (e.g., Birkinshaw, 1996; Birkinshaw and Hood, 1998), the essay examines the moderating roles of *investment purpose diversity* and *market-seeking orientation*. To empirically test the hypotheses in this essay, a paired-sample design of Japanese foreign subsidiaries entering Africa and OECD countries was used. This design helped minimize endogeneity concerns by comparing exit of foreign subsidiaries operating in Africa with counterfactual cases of subsidiary exits from the OECD countries (Reeb, Sakakibara, and Mahmood, 2012). Results from the extended cox regression models generate useful insights. First, the empirical evidence suggests that Japanese foreign subsidiaries that entered the African market have a greater likelihood of exiting than their counterparts in the OECD markets. This finding indicates that the economic (i.e., transaction cost) challenges of entry to the African market outweigh the associated strategic (i.e., market power) advantages.

Second, the empirical evidence suggests that Japanese foreign subsidiaries that entered Africa with diverse investment purposes and/or greater market-seeking orientation have registered a lower likelihood of exit than their counterparts. These findings, thus, present investment purpose diversity and market-seeking orientation as potential mechanisms to mitigate the economizing challenges of institutional voids. Further, the findings as well as theoretical arguments associated with investment purpose diversity can contribute to extending the firm scope argument to a subsidiary level (Khanna and Palepu, 2000; Wan, 2005; Wan and Hoskisson, 2003; Peng, Lee, and Wang, 2005). As such, the essay introduces the notion of *subsidiary scope,* here represented by the within-subsidiary diversity of purposes, and advance an understanding of its implications for

foreign subsidiary exit (or survival). As well, by considering investment purpose diversity, the essay addresses a call by Adner (2007) to engage the notion of *flexibility by reassignment of resources* (shifting resources to a more favorable activity in a subsidiary). Also, it finds that the unique structural and strategic attributes of market-seeking subsidiaries contribute to mitigating institutional hazards.

Essay 2 (Chapter 3) examines the effects of host-country market and institutional conditions on the survival likelihood of market-seeking subsidiaries. Entry of these subsidiaries to their respective host markets is contingent on the presence/absence of sufficient market opportunities in the host country (Brouthers, Gao, and McNicol, 2008). This essay argues that the pattern of *income distribution* in the host country is an important variable in determining market attractiveness and seek to explore how this variable relates to the survival (or exit) probability of market-seeking subsidiaries. Drawing on insights from research in environmental munificence, market imperfection, and NIE, the essay intended to examine the complex ways in which host-country income distribution is associated with survival of market-seeking foreign subsidiaries. As well, is explored institutional boundary conditions for the proposed relationship.

Analyses of subsidiary-, parent-, and country-level data on 6,699 Japanese market-seeking subsidiaries operating in 47 countries suggests that host-country income distribution has a non-linear relationship with subsidiary survival. Specifically, the essay finds empirical evidence suggesting a presence of a U-shaped relationship between income distribution and subsidiary exit in that subsidiary exit is high in host countries with highly egalitarian or highly dispersed income distributions. This empirical evidence supports the notion that market-seeking subsidiaries face a lower likelihood of exit in host countries with intermediate levels of income distribution (as measured by the Gini index). Post-hoc analyses indicates the inflection point to be at a Gini index

of approximately 38. The maximum and minimum Gini indices in the data are 57 and 22 respectively, and lower Gini score indicates more egalitarian income distribution.

Empirical findings also uncovered another layer of complexity in the relationship between income distribution patterns and exit of foreign subsidiaries. The study finds that development of free market institutions in the host country attenuates the relationship between income distribution and subsidiary exit. Host-country institutional development provide alternative mechanisms substituting for the hazard that extreme levels of income distribution (i.e., highly egalitarian or highly dispersed) pose. By reducing transaction and information costs associated with exchanges, free-market institutions compensate for the product and factor market limitations that extreme income distributions engender and improve host-country munificence (North, 1991; Shinkle and Kriauciunas, 2010; Xu and Meyer, 2013). As well as advancing a more nuanced understanding of how host-country income distribution relates with survival of market-seeking subsidiaries, this finding suggests the potential interaction between market and institutional factors and points to the need to examine such interactions to gain better understanding of subsidiary exit.

Like *Essay 1*, this essay advances the notion that the effects of market and institutional factors on foreign subsidiary survival is contingent on the purposes for which the subsidiary is established. Of special consideration here are market-seeking subsidiaries which differ from other types of subsidiaries in both structural and strategic terms. Structurally, these subsidiaries are horizontal extensions of and are loosely integrated with their respective parent firm as well as 'sister' subsidiaries (Nachum and Zaheer, 2005). Strategically, they are heavily dependent on host-country market and institutional conditions (Nachum and Zaheer, 2005; Slangen and Beugelsdijk, 2010). Such structural and strategic attributes of market-seeking subsidiaries provide an ideal context to

study the important issue of income distribution and its potential influence on subsidiary survival (Bidwell, Briscoe, Fernandez-Mateo, and Sterling, 2013; Davis, 2015; Davis and Cobb, 2010).

This essay makes several contributions. First, it extends our understanding of the subsidiary exit phenomenon by examining a variable—income distribution—that hitherto received a limited attention as a relevant factor in explaining business outcomes (Davis, 2015). Whereas the issue of income distribution has attracted a considerable public attention and remained central to studies in such disciplines as economics and sociology, it has yet to be considered relevant to studies in management (Bidwell, Briscoe, Fernandez-Mateo, and Sterling, 2013; Davis, 2015). Given the substantial role businesses play in influencing income distribution (Davis and Cobb, 2010), such disregard is hard to justify. Second, this essay points to the importance of refining our understanding of foreign subsidiaries by considering the purposes(motives) for which they are established. Specifically, by considering market-seeking subsidiaries, this essay advances the notion that the interface between host-country environment and MNE subsidiaries is contingent on the kind of subsidiaries under consideration and that different aspects of the environment are relevant for different kinds of subsidiaries (Castrogiovanni, 1991). Third, the essay also contributes to research on income distribution by indicating the potentially complex ways through which it relates to, or affects, different organizational outcomes.

Essay 3 (Chapter 4) examines the strategic implications of institutional voids by considering the potential effects of alternative governance structures to organize the relationship between MNEs and host countries. In emerging markets, where institutional voids abound, governments play a more active role in business activities and political connections yield greater benefits to business performance (Brockman, Rui, and Zou, 2013; Xu & Meyer, 2012). Whereas existing research indicates the presence of different governance structures (or bargaining models) underlying foreign

direct investments in developing countries, synthesizing these approaches and examining their comparative performance implication is largely limited. Essay 3 aims to contribute to filling this lacuna by identifying three alternative bargaining models—namely, the *one-tier bargaining*, the *modified one-tier bargaining*, and the *two-tier bargaining* models—and theoretically examining their characteristics using arguments from Hillman and Hitt (1999) about the nature of political actions. In doing so, the essay not only advances a better understanding of these bargaining models and their implications, but also offers a potential explanation for the increasing competitive edge of Chinese MNEs in such developing countries as those in Africa (Stevens and Newenham-Kahindi, 2017; UNCTAD, 2015).

Following Hillman and Hitt (1999), the essay categorized the three bargaining models along the two dimensions of the level and nature of political participation. The level of political participation takes either *individual* (i.e., MNE) or *collective* (i.e., state); the nature of political participation includes *transactional* or *relational*. Thus, using the dimensions, the essay identified that the modified one-tier model—typically characterizing Chinese resource-seeking FDI in such developing countries as those in Africa—follows the *collective-relational* approach to political connection. To establish a theoretical link between a given bargaining model and competitive advantage benefits spilling over to associated subsidiaries, the essay first forwarded theoretical mechanisms suggesting the marginal benefits of using collective as well as relational approaches to political connection. Then, it integrated mechanisms along the two dimensions to forward a proposition in support of a positive relationship between using the collective-relational approach (or the modified one-tier bargaining model) and competitive advantage of foreign subsidiaries. The proposition suggests the presence of *political rent* and its influence on market competition.

Resource-based view, resource dependence theory and NIE provided the requisite foundations for the theoretical development.

The essay further refined its theoretical development by identifying relevant boundary conditions to the proposed relationship. It identified investment motive and institutional development (economic and political) as potential boundary conditions influencing my baseline argument (i.e., the positive relationship between the use of the collective-relational approach and competitive advantage). The greater asset specificity characterizing resource-seeking investments manifest itself in increased threat of opportunistic behavior by host-country government (Anand and Singh, 1997; Dunning and Lundan, 2008). Such investments, therefore, place MNEs at a less favorable bargaining position (Pfeffer and Salancik, 1978). The collective-relational approach has a better potential of tipping the balance in favor of the MNEs and their respective subsidiaries. That is, the presence of a collective actor such as the home government and the inherent commitment to building long-term relationships underlying such approach has a potential to circumvent threats of reduced bargaining power. Also, the essay advances theoretical arguments suggesting the substitutive nature of advanced institutions and strong political connections. As economic and/or political institutions develop, MNEs tend to enjoy increasingly better protection of property rights and enforcement of contracts. Under this conditions, the potential spillover advantages flowing to foreign subsidiaries drawing on the collective-relational approach is likely to be inconsequential. This points to the potential tradeoff between market power advantage (through such strategizing efforts as political connection) and efficiency advantage (through reduced transaction costs) (Getachew and Beamish, 2017; Teece, Pisano, and Shuen, 1997).

Collectively, this dissertation makes the following empirical and theoretical contributions. First, it advances a more nuanced understanding of how host-country institutional conditions relate with

foreign divestment, by engaging both the economizing and strategizing mechanisms underlying institutional influences (Teece *et al.*, 1997; Williamson, 1991). Second, it integrates insights from the eclectic paradigm of foreign production and the investment motives literature to respond to calls for research looking at the interaction between location factors and investment motives (Dunning, 2009; Mesquita, 2016). Third, it contributes to the institutional voids literature by suggesting response mechanisms operating at the subsidiary level (i.e., investment purpose diversity and market-seeking orientation) and at the multi-party bargaining level (i.e., the modified one-tier bargaining model). Fourth, it contributes to our understanding of how the effects of host-country (dis)advantages can be best understood by identifying a form of organization for which such factors are more relevant. Fifth, it extends the investment motives literature by indicating the useful insights to be generated by considering fine-grained aspects of investment motives (i.e., investment purposes). Finally, it advances our understanding of foreign divestment by considering how market conditions, market-supporting institutions, and their interactions with investment motives relate with the exit likelihood of foreign subsidiaries.

This dissertation has important policy implications. It finds empirical evidence suggesting the potentially adverse effects of institutional voids for the viability of foreign subsidiaries. As such, improvement of host-country institutional conditions is important to realize the multi-faceted benefits of foreign investment to host country development. A particular emphasis may need to be placed on developing institutions pertinent to information access, property right protection, contract enforcement, and market entry. As well, the dissertation forwards theoretical arguments suggesting the benefits of institutional development in promoting social welfare by discouraging rent-seeking behaviors. Further, policies targeted at developing institutions can also contribute to limiting the adverse effects of such socio-economic conditions as extreme income distribution.

Limitations and future directions

The theoretical and empirical contributions of this dissertation notwithstanding, some caveats are in order. Empirical tests of the arguments in Essay 1 and Essay 2 are based on data from a single home country (i.e., Japan). This limits the generalizability of the findings and thus future research needs to verify the robustness of these arguments and the associated theoretical implications drawn using data on foreign subsidiaries originating from other countries. Nonetheless, the use of firms from a single home country achieves an empirical purpose of avoiding potential variance arising from the home country effects. As well, the firm- and subsidiary level data used in these two essays are extracted from a dataset with an extensive coverage (both in time and space) of Japanese foreign subsidiaries.

Another potential limitation lies in the measurement and operationalization of some of the constructs (or variables). For example, Essay 2 used the Gini index to measure the income distribution construct. While this measure is widely used and its data more comprehensively available, it may not fully capture the essence of the construct. In fact, influential research in income distribution has used the ratio measures such as such as *top 5 percent shares* as alternatives to the Gini index. Whereas a consensus on the specific measure to use for income distribution has yet to be reached, the value of verifying the robustness of the findings using alternative measures is unquestionable. Similarly, throughout the dissertation, the term 'emerging markets' was used as being synonymous with 'developing countries'. Such use, while necessary for the practical purposes of this research, may not be conceptually accurate. Whereas emerging markets refer to countries characterized by rapid economic growth and government policies favoring liberalization and free markets (Hoskisson *et al.*, 2000), not all developing countries subscribe to this characterization. Some African countries, for example, have neither rapidly growing economies

nor market-oriented government policies. Granted, there is a considerable overlap between the two (i.e., emerging market and developing countries) and both refer to contexts characterized by high institutional voids—a notion central to this dissertation.

This dissertation provides useful theoretical and empirical evidence indicating the need to consider both the structural and transaction-cost market imperfections typifying locations of high institutional voids. However, further study is required to better understand the dynamics between structural market imperfections responsible for the strategizing benefits and transaction-cost market imperfections responsible for economizing challenges. Whereas Essay 1 and Essay 3 examined subsidiary and country-level conditions influencing the dynamics between the two kinds of market imperfections, more needs to be done to determine additional boundary conditions, explore temporal dimensions, and understand the dynamics in light of evolutionary/revolutionary changes to the institutional environments of host countries.

A key element of the dissertation is the divestment of foreign subsidiaries, which is a key response variable in Essay 1 and Essay 2. The contributions of these essays notwithstanding, more work remains to better understand the association between institutional voids and foreign divestment. Foreign divestment is an important construct in IB research not least because it indicates sustainability or long-term performance. Foreign divestment can be an indication of failure in that the foreign subsidiary has not been successful in registering the desired level of performance. In contrast, it can also be a corporate strategy through which the parent MNE seeks to respond to changes. For example, it can result from a decision by an MNE to shift from hierarchy to market in response to progresses in the development of market-seeking institutions (Williamson, 2000). Distinguishing between these aspects of foreign divestment requires, among other things, accessing qualitative data which provides further insights about the rationale behind divestment

decisions. Therefore, future research drawing on such qualitative data will no doubt foster better understanding of foreign divestment and its relationship with institutional voids.

Another promising direction for future research resides in the study of investment motives (or purposes). A core element in the strategy formulation process of an MNE contemplating a move to a given host country is a decision/determination of the underlying investment motive/purpose. The motive/purpose specifies the *why* of the investment and has a potential implication for the extent to which the MNE achieves its purposes. This dissertation provides evidence suggesting that subsidiaries differing in the investment motive underlying their establishment (i.e., market seeking, resource seeking, efficiency seeking, and strategic-asset seeking) have different potentials of leveraging the strategizing advantage and/or mitigating the economic challenges of high institutional voids. That said, further research is warranted to verify these findings as well as identify additional mechanisms. Similarly, the dissertation indicated the value in disaggregating investment motives and consider specific purposes guiding foreign direct investment. A potentially fruitful future research agenda lies in considering the dynamic interactions between investment purposes (which may harbor MNE's perceptions and expectations about the host-country environments) and institutional voids (which the MNE subsidiary faces).

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Master of Business Administration

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PUBLISHED ARTICLES AND COMMENTS

Getachew YS, Beamish, PW. 2017. Foreign subsidiary exit from Africa: The effects of investment purpose diversity and orientation. *Global Strategy Journal*.

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Getachew YS. The modified one-tier bargaining model and shared value creation in international business. Theoretical development completed.

Getachew YS. MNE Subsidiaries as hybrid organizations: Responses to competing institutional demands from uncoordinated environments. Theoretical development completed.

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PUBLISHED CASE STUDIES

Getachew YS, Beamish, PW (2014). Ethiopian Airlines: Bringing Africa Together. *Ivey Case # 9B14M005* (*Teaching Note # 8B14M005*).
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TEACHING EXPERIENCE

Lecturer, *Strategic Management* (undergraduate core) Winter 2016
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Lecturer, School of Commerce, Addis Ababa University, Ethiopia 2007-2012
Taught *Strategic Management*, *Human Resource Management*, *Introduction to Management*, and *Operations Research*

Assistant Lecturer, Alpha University College, Ethiopia 2005-2007
Taught *Business Policy and Strategic Management, Statistics for Management,* and *Mathematics for Management*

Graduate Assistant, Saint Mary's University College, Ethiopia Mar. 2005- Nov. 2005
Taught *Marketing and salesmanship, Human Resource Management and Introduction to Management.*

Instructor, Unity University, Ethiopia 2004-2005
Taught *Introduction to Marketing* and *Marketing and Salesmanship*

SERVICES

- Assisted in the formation of partnership between Ivey Business School and the School of Commerce at Addis Ababa University for the Ubuntu Management Education Initiative at Ivey Business School 2013
- Assisting in the 39 Country Initiative at Ivey Business School, Western University 2012- Now
- Ad Hoc Reviewer for Academy of Management Conference 2015
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HONORS AND AWARDS

- The Plan for Excellence Doctoral Fellowship, Ivey Business School ($146,192) 2012-2016
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- A Gold-Medal in a B.A degree in Business Management at Jimma University with a CGPA of 3.96 and Major GPA of 4.0 2004
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