Investment Motives and Non-Traditional Foreign Direct Investment

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Abstract

This dissertation examines the characteristics and performance of non-traditional investment motives, with a secondary focus on small-employment subsidiaries. It also investigates how firms re-evaluate and change their organizational control after an industry-wide consumer confidence crisis.

Essay 1 (Chapter 2) examines the characteristics and performance of subsidiaries according to different investment purposes, with a special emphasis on non-traditional investment motives. The key characteristics examined in Essay 1 include the size of an affiliate, the ownership mode, expatriate control, and performance. It finds that FDI with a support function differs substantially from a typical manufacturing facility. Meanwhile, there is a huge difference among sub-categories of major investment motives.

Essay 2 (Chapter 3) examines the relationship between subsidiary size and survival. The main theoretical/conceptual lenses are the liability of smallness and orchestration theory. Using a large sample of Japanese FDI, we found that small subsidiaries have a higher exit rate than large ones. Further, this relationship is moderated by four factors: (1) serving as a center of importance; (2) vertical investment; (3) being in a human-capital-intensive industry; and (4) being located in a developed country.

Essay 3 (Chapter 4) examines MNEs’ responses to an industry-wide consumer confidence crisis. This study draws on the theoretical lens of transaction cost economics (TCE) and institutional theory. This study finds that Japanese MNEs in the crisis sector undertook more entries, especially in the service segment. MNEs also undertook fewer exits in the crisis sector, especially in the manufacturing segment. Due to demand uncertainty induced by the crisis, MNEs lowered their ownership level to reduce their exposure to risk in the crisis sector, especially in the manufacturing segment. Moreover, majority owners were more likely to increase organizational control, compared with minority owners. Majority owners were also more likely to exit, compared with WOS or minority owners.
On the whole, this dissertation challenges our existing view of a “typical” subsidiary in a “typical” investment setting. It also reemphasizes the centrality of investment motives to firm internationalization research and recommends a routine inclusion of investment motives in IB research.

Keywords
Investment motives, size, mode, organization control, expatriate control, performance, survival, liability of smallness, orchestration theory, TCE, environmental uncertainty, demand uncertainty, behavioral uncertainty, legitimacy, reputation.
Summary for Lay Audience

This dissertation examines the characteristics and performance of non-traditional investment motives, with a secondary focus on small-employment subsidiaries. It also investigates how firms re-evaluate and change their organizational control after an industry-wide consumer confidence crisis.

Essay 1 (Chapter 2) examines the characteristics and performance of subsidiaries according to different investment purposes, with a special emphasis on non-traditional investment motives. The key characteristics examined in Essay 1 include the size of an affiliate, the ownership mode, expatriate control, and performance. It finds that FDI with a support function differs substantially from a typical manufacturing facility. Meanwhile, there is a huge difference among sub-categories of major investment motives.

Essay 2 (Chapter 3) examines the relationship between subsidiary size and survival. The main theoretical/conceptual lenses are the liability of smallness and orchestration theory. Using a large sample of Japanese FDI, we found that small subsidiaries have a higher exit rate than large ones. Further, this relationship is moderated by four factors: (1) serving as a center of importance; (2) vertical investment; (3) being in a human-capital-intensive industry; and (4) being located in a developed country.

Essay 3 (Chapter 4) examines MNEs’ responses to an industry-wide consumer confidence crisis. This study draws on the theoretical lens of transaction cost economics (TCE) and institutional theory. This study finds that Japanese MNEs in the crisis sector undertook more entries, especially in the service segment. MNEs also undertook fewer exits in the crisis sector, especially in the manufacturing segment. Due to demand uncertainty induced by the crisis, MNEs lowered their ownership level to reduce their exposure to risk in the crisis sector, especially in the manufacturing segment. Moreover, majority owners were more likely to increase organizational control, compared with minority owners. Majority owners were also more likely to exit, compared with WOS or minority owners.

On the whole, this dissertation challenges our existing view of a “typical” subsidiary in a “typical” investment setting. It also reemphasizes the centrality of investment motives to firm
internationalization research and recommends a routine inclusion of investment motives in IB research.
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Chapter 1

1 Introduction

Multinational enterprises (MNEs) have different investment motives for their foreign direct investment (FDI) (Dunning, 1993; Dunning & Lundan, 2008). For example, one MNE may invest in Africa to access minerals and natural resources, while another MNE may invest in the United States to gain access to the local market, e.g., Toyota’s manufacturing investments in six U.S. states. After an MNE has gained some experience in FDI, it may opt to reconfigure its existing subsidiaries. This might occur by shifting manufacturing subsidiaries to developing countries while opening new R&D centers in developed countries. Recently, MNEs from emerging markets (EMNEs) have acquired technologically advanced firms for the purpose of strategic asset seeking, i.e., to augment their long-term competitive advantage (Buckley, Clegg, Cross, Liu, Voss, & Zheng, 2007; Luo & Tung, 2018; Meyer, 2015; Narula, 2012). The abovementioned firms are typically engaged in FDI for the purposes of resource seeking, market seeking, efficiency seeking, or strategic asset seeking, which are the four major investment motives in Dunning’s original typology.

Hennart and Slangen (2015: 117) urged scholars “to start paying more attention to actual choices that were theoretically suboptimal, that is, choices deviating from a model’s theoretical prediction… especially their evolution over time vis-à-vis theoretically optimal choices.” This dissertation is a direct response to this call, as it examines the characteristics and performance of non-traditional investment motives and small-employment subsidiaries. It also examines how firms changed their organizational arrangement after an industry-wide consumer confidence crisis.

This dissertation systematically examines the role of investment motives in firm internationalization. The first two essays investigate the characteristics and performance of FDI according to different investment purposes, with particular attention given to non-traditional investment motives such as management-supportive investment (i.e., controlling business in the area), trade-supportive investment (i.e., information gathering
and royalty collection), and finance-supportive investment (i.e., financing and currency hedging). The *Toyo Keizai* dataset (TK dataset), which covers Japanese overseas investment from 1991 to 2017, is used for our empirical analysis. In total, subsidiaries with the abovementioned non-traditional investment motives represent about 15% of all subsidiaries. In the TK dataset, 61,695 subsidiary-year observations (8,642 subsidiaries) belong to the category of non-traditional motives and these subsidiary-year observations report an average annual revenue of US$50 million. Collectively, these represent approximately US$3 trillion of investment.

Following the theme of non-traditional FDI, the third essay investigates MNEs’ responses to an industry-wide crisis setting. The crisis management literature on FDI has focused on the determinants of survival or exit and has largely neglected those MNEs that continue to operate during a crisis. For exceptions, see Chung & Beamish, 2005; Chung, Lee, Beamish, Southam, & Nam, 2013; Zhou, Park, & Zhou, 2014. This study addresses the gap by theoretically drawing on transaction cost economics (TCE) and institutional theory (i.e., legitimacy and reputation) to systematically investigate the repertoire of strategies that MNEs can deploy during a crisis. It shows that there are even investment opportunities for MNEs to explore during an industry wide consumer confidence crisis, which constitutes the non-traditional element in this study.

This chapter proceeds by introducing the motivation of the dissertation, providing an overview of three integrated essays, and suggesting intended contributions to the FDI literature.

### 1.1 Motivation for Essays 1 and 2 of the Dissertation

Most previous studies on investment motives have covered the four major motivations, i.e., market seeking, resource seeking, efficiency seeking, and strategic asset seeking (Dunning, 1993; Dunning & Lundan, 2008). However, subsidiaries are heterogeneous due to their differences in investment motives (Beugelsdijk, Hennart, Slangen, & Smeets, 2010). Because of the different strategic roles undertaken by subsidiaries, they have corresponding structural forms that affect their level of autonomy and performance.
(Birkinshaw & Morrison, 1995). As MNEs orchestrate the global process of value creation and capture, they tend to adopt a “portfolio of entry modalities” (Pitelis & Teece, 2018: 535). In fact, due to structural, financial, and legal reasons, there are many types of subsidiaries that differ from the image of a typical subsidiary as a standalone manufacturing facility. For example, there are sometimes very large subsidiaries in terms of sales, but with few or no employees. Hence, there are sound theoretical and empirical reasons to investigate those subsidiaries established for non-traditional investment motives.

Indeed, other investment motives do exist in Dunning’s (1993) original typology, such as in the case of escape, passive, and support investments. The latter include management-supportive investments, trade-supportive investments, and finance-supportive investments (Cuervo-Cazurra & Narula, 2012). Non-traditional motives have been traditionally regarded as secondary and have received much less attention from scholars in their studies (Cuervo-Cazurra & Narula, 2015). Nonetheless, a few non-traditional investment motives have received at least some scrutiny. For example, there have been studies about (i) regional management centers (e.g., Ambos, Schlegelmilch, Ambos, & Brenner 2009; Chakravarty, Hsieh, Schotter, & Beamish, 2017; Lasserre, 1996; Schotter, Stallkamp, & Pinkham, 2017; Verbeke & Asmussen, 2016) and (ii) escape investment (e.g., Cuervo-Cazurra, Narula, & Un, 2015; Barnard & Luiz, 2018; Boisot & Meyer, 2008; Fathallah, Branzei, & Schaan, 2018; Kobrak, Oesterle, & Röber, 2018; Li, Xia, Shapiro, & Lin, 2018; Shi, Sun, Yan, & Zhu, 2017; Weng & Peng, 2018; Witt & Lewin, 2007). The main theoretical lens for studying escape investment is institutional arbitrage, i.e., to escape weak institutions in the home country for a better institutional environment in the host country (Boisot & Meyer, 2008; Cuervo-Cazurra, Narula, & Un, 2015; Witt & Lewin, 2007). Escape investment is not examined in this thesis. The main theoretical lens for regional management centers is the integration–responsiveness framework (Bartlett & Ghoshal, 1989; Rugman & Verbeke, 2004; Verbeke & Asmussen, 2016). Partial overlap exists between regional management centers and subsidiaries with management-supportive functions, which are examined in this thesis.
The focus of this thesis is on support investments, including management-supportive investments, trade-supportive investments, and finance-supportive investments. Subsidiaries established for these purposes are not self-contained profit centers. They incur costs, but the benefits accrue to the MNE as a whole (Dunning & Lundan, 2008). For example, management-supportive investments include those regional and branch offices that act as intermediaries between head offices and foreign subsidiaries. Subsidiaries with trade-supportive functions usually facilitate the import and export of goods and services. They also provide marketing and public-relations services for their parent companies, such as information gathering and royalty collection, which is the first step in setting up a market- or resource-seeking affiliate.

Finance-supportive investments provide financing and currency-hedging services to the MNE. Special-purpose vehicles (SPVs) are one type of financing investment. They are “essentially robot firms that have no employees, make no substantive economic decisions, have no physical location, cannot go bankrupt” (Gorton & Souleles, 2007: 550). SPVs are set up for the purpose of accessing low-cost financing, avoiding tax, and taking debt off the balance sheet for the parent firm (PwC, 2011). They are passive in business decision making and have no employees. Yet these SPVs serve important functions in the MNE global network. However, investment with finance-supportive functions has been routinely excluded from FDI studies (e.g., Blevins, Moschieri, Pinkham, & Ragozzino, 2016; Reuer & Ragozzino, 2008).

Why has it been so difficult to empirically investigate non-traditional investment motivations? There are two primary reasons. The first is that many existing studies on investment motives have used aggregate-level data, e.g., at the country level (Brouthers, Gao, & McNicol, 2008) or industry level (Nachum & Zaheer, 2005), as a proxy for the four major investment motives. For example, Brouthers et al. (2008) used country-level United Nations Conference on Trade and Development (UNCTAD) data. Market-seeking FDI was calculated using the average multilateral FDI flows in the industries of wholesaling, retailing, transportation, storage, communications, real estate, and financial services, while FDI in the industries of textiles, machinery and equipment manufacturing, and clothing was treated as labor-seeking FDI. Nachum and Zaheer (2005) used industry-
level data under the assumption that the industry averages equate to a “representative” firm in the industry. In their study, local market-seeking efforts were measured using the cost of sales of affiliates as a share of total costs. However, it is difficult to find proxies for non-traditional motivations using aggregate-level data. The second reason it has been so difficult to empirically investigate non-traditional investment motivations is that for datasets like the TK dataset where detailed information on subsidiary motives is available, researchers have realized that small subsidiaries with fewer than 20 employees are qualitatively different from typical manufacturing facilities (Beamish & Inkpen, 1998). As a result, subsidiaries with fewer than 20 employees have routinely been excluded from analysis.

1.1.1 Motivation for Studying Small-Employment Subsidiaries

Because none of the 160+ publications from Ivey faculty and Ph.D. candidates and graduates based on the TK dataset have focused on small-employment subsidiaries, we conducted a preliminary analysis of Japanese FDI with small-scale employment. An empirical analysis of the TK dataset (1991–2017 version) shows that there were 557,179 subsidiary-year observations (56,193 subsidiaries), among which 406,282 observations (44,220 subsidiaries) reported information on the number of employees. Among them, 150,823 subsidiary-year observations (37% of all subsidiary-year observations, involving 24,466 subsidiaries) had fewer than 20 employees and 22,261 subsidiary-year observations (5.5% of all subsidiary-year observations, involving 5,790 subsidiaries) had zero employees. For example, (1) Toshiba Capital Asia was one such Japanese affiliate with 19 employees, yet it reported revenue of a whopping US$71.4 billion in 2013. It was a wholly owned subsidiary (WOS) of its Japanese parent firm, Toshiba, and its main business was loans and credit cards. (2) Kumagai Australia Finance Ltd was another Japanese affiliate that was 100% owned by the Japanese parent firm. It also operated in the loan/credit card sector, had three employees, and reported revenue of US$15 billion.

in 1992. (3) Visualant was a U.S. high-tech company that sold proprietary technology solutions for identification, authentication, and diagnosis. The company, whose Japanese parent owned 10.5%, had 10 employees and reported revenue of US$9.1 billion in 2015. (4) KG International Petroleum was a wholesale company with eight employees and it generated US$7.8 billion in 1998. (5) Marubeni Motor Service was another Japanese affiliate that operated in the loan/credit card sector. It had four employees and reported revenue of US$6.9 billion in 1999. In sum, these five affiliates had a total of 44 employees, yet reported revenue of US$110.2 billion.

There were also affiliates that reported zero employees. Here, a similar pattern existed. (1) Valepar S.A. was a Japanese affiliate with a turnover of US$48.3 billion in 2013 and its main business was financial services for mining. Japan’s Mitsui owned 18.2% of the shares. (2) Toyota Motor North America, an investment/management company, reported revenue of US$27.5 billion in 1998. It was an affiliate with no employees, and was a 100% owned subsidiary of Toyota. (3) Dia Chemical Taiwan was a 100% owned Japanese subsidiary in the chemical wholesale industry and reported revenue of US$23 billion in 2010. (4) Itochu Petroleum (a WOS) reported revenue of US$15.2 billion in 2009, and was another Japanese affiliate in the wholesale trade sector. (5) Mitsui Oil Hong Kong was a 100% owned Japanese affiliate in the oil wholesale industry, and reported revenue of US$11.6 billion in 2012. In sum, all these affiliates reported zero employees, but were able to generate billions of dollars in revenue. Such unusual yet financially significant practices among MNE subsidiaries warrant further study.

1.2 Motivation for Essay 3 of the Dissertation

Essay 3 is motivated by empirical observations of an industry-wide consumer confidence crisis in the Chinese food industry in 2008. The melamine-contaminated baby formula scandal in 2008 was the major event that made Chinese consumers think twice before purchasing domestically produced food products. Besides melamine-contaminated milk products, there were also media reports about banned cooking oil (Wu & Chen, 2013) and pork contaminated with chemicals. In a survey conducted by the Chinese government in 2012, 41% of respondents reported that food safety was a “serious problem.” Food safety concerns, along with inequality and corruption, represented three top governance
concerns of the Chinese population (Yasuda, 2015). The baby formula crisis offers a natural experimental setting to study crisis responses by MNEs.

Meanwhile, there is a research gap in the crisis management literature (Bondy, Pfarrer, Short, & Coombs, 2016) as it relates to international management (Hasse, 2016; Naidoo, 2010; Zhao, Park, & Zhou, 2014). When facing potential risks or economic crises, MNEs adopt a “fight” or “flight” attitude. Most literature on crisis management and FDI has focused on the “flight” scenario and has investigated the determinants of survival (e.g., Chung & Beamish, 2015; Dai, Eden, & Beamish, 2013, 2017). There are only a few exceptions that examine how MNEs “fight” or adjust their operations to survive the crisis (e.g., Chung & Beamish, 2008; Chung et al., 2013; Naidoo, 2010; Zhao, Park, & Zhou, 2014). This study addresses this research gap by investigating the repertoire of strategies that MNEs can deploy in a crisis.

In addition, previous crisis management research in international business has mostly focused on regional or country-level crises (e.g. Chung et al., 2013; Dai, Eden, & Beamish, 2013, 2017) or MNE-firm-level crises (e.g. Zhao, Park, & Zhou, 2014). This study adds to the literature by focusing on an industry-level crisis.

1.3 Dissertation Overview

Essays 1 and 2 of this dissertation systematically examine the role of investment motives on firm internationalization. They do so via two integrated essays, with a focus on non-traditional investment motives and small-employment subsidiaries. Following the theme of non-traditional FDI, Essay 3 examines MNEs’ responses to an industry-wide crisis.

Essay 1 (Chapter 2) emphasizes the centrality of investment motives in international business (IB) studies by proposing a theoretical framework for the antecedents and consequences of investment motives (see Figure A). It integrates a) the theoretical argument that an MNE’s ownership advantages (O-advantages) interact with the location advantages (L-advantages) of host and home countries to jointly determine the type of investment motive(s) of an affiliate (Cuervo-Cazurra & Narula, 2015; Narula, 2012; Meyer, Mudambi, & Narula, 2011) and b) a theoretical framework of the effects of
investment motives on subsidiary-level characteristics and performance (Benito, 2015). To achieve that goal, four hypotheses were developed. Unlike the existing literature on the OLI paradigm which uses the umbrella term of country specific advantages (CSAs), we differentiate between host country specific advantages (host CSAs) and home country specific advantages (home CSAs).

**Figure A: Theoretical framework for understanding investment motives**

The data analysis looks at the characteristics and performance of subsidiaries according to different investment purposes (Chakravarty, Hsieh, Schotter, & Beamish, 2017; Makino, Beamish, & Zhao, 2004), with a special emphasis on non-traditional investment motives. Although there exist different classification typologies of investment purposes (e.g., Cuervo-Cazurra, Narula, & Un, 2015; Behrman, 1972; Hollander, 1970; Hymer, 1976; Kacker, 1985; Porter, 1986; Dunning, 1993; Dunning & Lundan, 2008), as a baseline, we adopt the typology proposed by Dunning (1993). In addition to the four main investment motives (Dunning, 1993; Dunning & Lundan, 2008), this essay pays special attention to two other categories of investment purposes: support investments and passive investments. Essay 1 addresses two research questions: (1) What are the
determinants of investment motives? (2) How do subsidiaries with different investment purposes differ in their characteristics and performance?

The key characteristics examined in Essay 1 include subsidiary-level characteristics such as the size of the affiliate (measured by the number of local employees), the ownership mode (wholly owned subsidiary, majority-owned subsidiary, equally owned subsidiary, and minority-owned subsidiary), expatriate control (expatriate number, expatriate percentage), and performance (measured by both revenue and subjective evaluation).

Essay 2 (Chapter 3) examines the relationship between subsidiary size and survival. It addresses two research questions: (1) What is the main relationship between subsidiary size and survival? (2) How is the main effect moderated by the special roles of small-employment subsidiaries? Examples of such roles include those serving as centers of importance and vertical investment.

The main theoretical lens is the liability of smallness (Aldrich & Auster, 1986) and orchestration theory (Pitelis & Teece, 2018). The main statistical model is the Cox proportional hazards model. Using a sample of Japanese overseas FDI, we found that smaller subsidiaries have a higher exit rate than larger ones. Further, we also found that the liability of smallness is conditional upon the following four factors: (1) serving as a center of importance; (2) vertical investment; (3) being in a human-capital-intensive industry; and (4) being located in a developed country.

Essay 3 (Chapter 4) examines MNEs’ responses to the food safety crisis in China in 2008. It addresses the following four research questions: (1) Does the crisis trigger more foreign entries in the crisis sector? (2) Does the crisis trigger fewer foreign exits in the crisis sector? (3) What is the impact of demand uncertainty on MNEs’ subsidiary control in the crisis sector? (4) What is the effect of MNEs’ equity position (i.e., WOS, majority equity, minority equity) on subsidiary control in the crisis sector? The main theoretical lens is TCE (Coase, 1937; Williamson, 1975; Hennart, 1982) and institutional theory (i.e., legitimacy and reputation) (Kostova & Zaheer, 1999; Rao, 1994).
Using a large sample of Japanese MNEs in China with 79,528 subsidiary-year observations, our results show that the crisis triggered more foreign entries in the crisis sector, especially in the service segment. Meanwhile, the crisis also triggered fewer foreign exits, especially in the manufacturing segment. With regard to existing operations, MNEs lowered their equity control to reduce their exposure to risk. Moreover, MNEs of different equity positions (i.e., WOS, majority, and minority) were under varying levels of partner opportunism and reputational risk. As a result, majority owners were more likely to increase their ownership level to ensure quality control than minority owners. Majority owners were also more likely to disassociate from the reputational risk through divestment, compared with WOS and minority owners.

1.4 Contributions

This dissertation hopes to make various contributions to the literature by reemphasizing the centrality of investment motives to IB research and focusing on non-traditional FDI, including non-traditional investment motives, small-employment subsidiaries, and industry-level crises. Taken together, this dissertation challenges our existing view of a “typical” subsidiary in a “typical” FDI setting.

Essay 1 reemphasizes the centrality of investment purposes to research on firm internationalization (Benito, 2015; Dunning & Lundan, 2008). It is the first empirical attempt to systematically test Dunning’s (1993) typology on investment motives, using the largest sample ever employed to date. Dunning’s original typology offered definitions and examples for each type of investment motive. This study suggests that Dunning’s typology does have predictive power for key characteristics (such as size, ownership control, and expatriate control) and performance outcomes. It extends Dunning’s typology by offering theoretical explanations to account for differences among FDI with divergent investment purposes. It also makes an empirical contribution by including all categories specified in Dunning’s (1993) typology, whereas most previous empirical studies examined only one or two investment purposes per study, sometimes in a piecemeal fashion.
Second, this study provides a nuanced picture of FDI in functions such as “financing and hedging,” “information gathering and royalty revenue,” and “building new business,” which have been neglected in most empirical analyses of investment motives (Cuervo-Cazurra & Narula, 2015). These investment motives are not only important in a strategic sense, but also in investment dollars. FDI with these motives is substantially different from other types of FDI and collectively exemplifies the central theme of this dissertation—that there is huge heterogeneity (Birkinshaw & Hood, 2008) among subsidiaries. Hence, there is a need to disaggregate data and treat investments with different investment motives separately. We also argue that where data is available, investment motives should be routinely included in an IB analysis looking at foreign investment.

Third, our results show that there is a huge difference among subcategories of major investment motives. For example, under the big umbrella of “market-seeking” FDI, there are four subcategories—that is, “local market access,” “tax breaks for investment,” “alliances with customers in Japan,” and “building new business.” The latter three subcategories are substantially different from the first subcategory in all four of the characteristics and performance measures tested in the present research. This suggests that future IB studies should consider investment motives at the subcategory level.

Essay 2 makes at least two contributions to the literature. First, we quantify the liability of smallness by exploring the survival likelihood of small-employment subsidiaries. Second, we identify four contingency factors that enhance the survival chances of small-employment subsidiaries. These are the special roles of i) centers of importance, (ii) vertical investment, (iii) being in a human-capital-intensive industry, and (iv) being located in a developed country.

Essay 3 (Chapter 4) makes at least three contributions to the literature. First, it contributes to TCE and extends the theoretical argument about external uncertainty, especially demand uncertainty. Consistent with prior research on entry-mode choice (i.e., IJVs or WOSs) (Gatignon & Anderson, 1988; Sartor & Beamish, 2014) and post-entry-mode conversion (i.e., conversion from IJVs to WOSs) (e.g., Puck et al., 2009), it suggests that
MNEs reduced their equity control to cope with environmental uncertainty. It goes beyond prior research by extending the argument about external uncertainty and organizational control in a post-entry crisis empirical setting.

In addition, we examined the relationship between behavioral uncertainty (i.e., partner opportunism) and organizational control by introducing the concepts of reputational risk and MNEs’ equity position. The results show that compared with WOS and minority owners, majority owners are at high levels of both operational and reputational risk. As a result, majority owners will either choose to a) increase their ownership level to exert more organizational control in order to ensure product quality or b) disassociate themselves from the IJV through divestment in order to avoid reputational damage to their global brand and operation. To our knowledge, this is the first study that investigates the strategic options of MNEs of different equity positions in coping with partner opportunism.

Second, our study extends Kostova and Zaheer’s (1999) argument that the illegitimacy of local firms provides non-local firms with an initial level of legitimacy in entry and exit decisions. Integrating the country-of-origin literature, which highlights the trade-offs between symbolic value (Zhou & Hui, 2003) and perceived quality (Knight, Holdsworth, & Mather, 2007) in consumer decisions, we argue and show empirically that MNEs are more likely to enter and less likely to exit a market in an industry where local producers are facing a crisis.

Third, we contribute to the crisis management literature (Bondy, Pfarrer, Short, & Coombs, 2016) as it relates to international management (Hasse, 2016; Naidoo, 2010; Zhao et al., 2014). When facing a political or economic crisis, many MNEs assume a “fight” or “flight” attitude. Most literature on crisis management and FDI has focused on the “flight” scenario and has explored the determinants of survival (e.g., Chung & Beamish, 2005; Chung et al., 2013; Dai, Eden, & Beamish, 2013, 2017). There have been few examples of how MNEs “fight” or adapt their operations to survive a crisis (e.g., Chung & Beamish, 2008; Chung et al., 2010; Naidoo, 2010; Zhao et al., 2014). Our research adds to the second line of literature by showing that MNEs have a repertoire of
strategies of entering, exiting, lowering or increasing their ownership level, or simply remaining unchanged, which depends on their equity position and industry segment.
References


Chapter 2

2 The Characteristics and Performance of Foreign Direct Investment According to Investment Motives

This chapter describes the characteristics and performance of FDI according to investment motives. Such a focus was driven by both theoretical and empirical reasons.

At the theoretical level, investment motives are key to the understanding of MNE activity (Dunning & Lundan, 2008; Mesquita, 2016; Nachum & Zaheer, 2005). Dunning and Lundan (2008) argued that “any theory of the MNE critically depends on the presumed motivation and intention of the enterprise involved” (p. 81). Investment motives are systematically associated with the central aspects of internationalization, because they help to identify location choices and evaluate performance outcomes (Benito, 2015).

When an MNE with adequate capital in hand is contemplating internationalization, it may have multiple location choices in mind. If its investment motive is to seek raw material resources, it may choose resource-rich locations such as Africa. If the same company intends to seek market access, it may choose locations with high population density and potential for market growth.

Moreover, the evaluation of performance outcome is contingent upon investment motives (Benito, 2015; Meyer, 2015; Verbeke & Brugman, 2009; Verbeke, Li, & Goerzen, 2009; Verbeke & Forootan, 2012). For example, a natural-resource-seeking subsidiary may be a cost center, which makes it irrelevant to judge its performance on profitability. In strategic-asset-seeking FDI, the improved capability of the parent firm, such as R&D output, is a better performance evaluation criterion than the short-term profitability of the focal subsidiary.

However, the investment motives behind the internationalization of the firm have been largely assumed or taken for granted in IB literature (Cuervo-Cazurra, Narula, & Un, 2015). Most theories assume a market-seeking motive for firm internationalization (Benito, 2015). Take the incremental internationalization process model, or “the Uppsala school” (Johanson & Vahlne, 1977), as an example. The implicit assumption is that firms seek market access in the host country. Yet the sequential entry model is more applicable
to market-seeking behavior, but less applicable to strategic-asset-seeking FDI (Benito, 2015; Dunning & Lundan, 2008). Thus, internationalization theories may be incomplete unless they take into consideration all major types of investment motives.

At the empirical level, most research on firm internationalization has extensively studied the “who” (firm-specific advantages, or FSAs), “where” (location), “how” (internalization; sequential entry; incremental commitment; diversification), and “so what” (performance) parts of firm internationalization. However, little attention has been paid to the “why” or motivations behind a firm’s strategic decision to internationalize (Benito, 2015; Dunning & Lundan, 2008). Although the centrality of investment motives in firm internationalization makes it relevant to study their direct or moderating effect (Benito, 2015), the role and nature of investment motives have only been “sporadically considered” in empirical research (Beamish & Lutpon, 2016).

This chapter attempts to fill this research gap by systematically examining affiliate-level characteristics and performance according to investment motives. It uses the Kaigai Shinshutsu Kigyo Soran (Japanese Overseas Investment) dataset (Toyo Keizai, 2017) for subsidiary-level information. The TK dataset has 557,179 subsidiary-year observations (56,193 subsidiaries) and 194,171 observations reported with up to eight investment purposes.

We intend to make three contributions. First, there are investment motivations that have received little or no attention in the vast majority of empirical IB studies, such as “financing and currency hedging” (J), “information gathering and royalty revenue” (K), and “building new business” (M). These investment motives are important not only in a strategic sense, but also in terms of investment dollars. For example, investments in “financing and currency hedging” (J) reported an annual revenue2 of US$62 million per subsidiary and collective annual revenue of US$126 billion. Second, investments with the purpose of “local market access” (F) accounted for about half of all investment (48.32%).

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2 Unless otherwise specified, revenue refers to average annual revenue.
Under the general large category of “market access,” there are other subcategories as well, such as “tax breaks for investment” (C), “alliances with Japanese customers” (I), and “building new business” (M). These subcategories have different characteristics compared with the subcategory of “local market access.” For example, those with the investment purpose of “local market access” reported average annual revenue of US$59 million, but the average annual revenue recorded by other subcategories was much lower: US$28 million for “tax breaks for investment,” US$26 million for “alliances with customers in Japan,” and US$10 million for “building new business.” Third, investments of various investment purposes have very different characteristics, as will be explained below. Some particular types of investment such as “financing and currency hedging” and “information collection and royalty revenue” represent particular types of investments that are different from a standard subsidiary. Hence, it is misleading and inappropriate to aggregate data from all various investment purposes, as occurs in most IB research. Thus, we suggest that scholars should disaggregate analyses according to investment purposes and conduct more fine-grained analysis.

This chapter starts with a review of the literature on the characteristics and performance of FDI according to investment motives. Then a theoretical framework for the antecedents and consequences of investment motives is proposed, which integrates two existing theoretical paradigms in the literature. In total, four hypotheses are developed. Of these, so far, Hypotheses 3 and 4 have been tested and are discussed in this essay. This is followed by discussion of the data source and preliminary data analysis, then presentation of results and discussion.

2.1 Literature Review

This section reviews the literature on the conceptual typology and empirical measurement of investment motives, and the effect of investment motives on subsidiary characteristics and performance. This literature review limited the scope of research to leading international business, management, and strategy journals. We identified eight core IB journals: Global Strategy Journal (GSJ), International Business Review (IBR), International Journal of Management Reviews (IJMR), Journal of International Business Studies (JIBS), Journal of International Management (JIM), Journal of World Business
We also searched 15 leading management/strategy journals: Academy of Management Annals (AMA), Academy of Management Journal (AMJ), Academy of Management Perspectives (AMP), Academy of Management Review (AMR), Asia Pacific Journal of Management (APJM), British Journal of Management (BJM), European Journal of Management (EJM), Harvard Business Review (HBV), Journal of Management (JOM), Journal of Management Studies (JMS), Long Range Planning (LRP), Management and Organization Review (MOR), Organization Studies (OS), Organization Science (OS), and Strategic Management Journal (SMJ) (Kim & Aguilera, 2016). The time window of the analysis was the 30 years from January 1988 to January 2018.

The following keywords were used to search for relevant articles published in the abovementioned journals: (1) “investment motive(s)”; (2) “investment purpose(s)”;(3) “investment motivation(s)”; (4) “seeking” AND “foreign investment”; (5) “seeker” AND “foreign investment”; (6) “types of FDI(s)”; and (7) “kinds of FDI(s).”

After all the relevant articles had been identified, these articles were categorized according to the following three topics: (1) the theoretical development of the typology of investment motives of FDI; (2) the empirical measurement of the theoretical construct of investment motives; and (3) the characteristics and performance of subsidiaries according to investment motives.

2.1.1 Theoretical Construct of Investment Motives

This section traces the historical development of the concept of “investment motive,” its main typologies, the multiplicity of investment motives, and how investment motives change over time.

2.1.1.1 Main Typology of Investment Motives

MNEs internationalize for various reasons and scholars have proposed different classifications of motives (see Table 1). Building on the efforts of early work on investment motives, Dunning (1993) offered the most comprehensive typology on
investment motives. It considers four major investment motives (i.e., resource seeking, market seeking, efficiency seeking, and strategic asset seeking) and three minor ones (i.e., support investment, escape investment, and passive investment). Later scholars added different dimensions to the typology, such as industry competitive pressure (Nachum & Zaheer, 2005), the host- and home-country conditions (Cuervo-Cazurra, Narula, & Un, 2015), the geopolitical influence of the home country (Moghaddam et al., 2014), and instant reaction to opportunities (Luo & Tung, 2007, 2018). A suggested direction for future research is to add a time dimension to the typology, i.e., to differentiate investments for current revenue generation and cost cutting and those intended for future revenue generation (such as building new business and strategic asset seeking).

Table 1: Main typologies of investment motives

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<td>End customer market seeking</td>
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<td>Resource seeking</td>
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<td>Natural resource seeking; efficiency seeking</td>
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<td>Efficiency seeking</td>
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<td>Strategic asset seeking</td>
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<td>Competitive strategic motivation</td>
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Hollander (1970) argued that the main driver for internationalization is for the pursuit of sales and he classified investment motives into commercial, non-commercial, and inadvertent. Hymer (1976) took a holistic approach to the value chain and proposed that MNEs internationalize for the purpose of either vertical integration or horizontal
expansion. Porter (1986) built on the idea of the value chain and classified FDI into two categories: upstream (raw materials) and downstream (distribution). In addition to the focus on the value chain, Kacker (1985) introduced the concept of external market forces and identified the pull factor of the host market (market growth) and the push factor of the home market (market saturation) for MNE internationalization. Dunning (1993) proposed the best-known classification of investment motives, which covers both the internal drive of the MNE (e.g., competence exploiting and competence augmentation) and the external factors of the host and home markets.

Building on Behrman’s (1972) early taxonomy on motives behind FDI, Dunning (1993) proposed four main types of investment motives. (1) Natural resource seekers are interested in gaining access to physical resources and cheap labor. (2) Market seekers are motivated to protect their existing markets or explore new markets, especially when the host government imposes tariffs on imported products, e.g., a market seeker relocates its domestic production facility to a foreign location. Market seekers are also motivated to adapt their products to local needs, to have a tradeoff between transportation and production costs, and to follow the strategic moves of their customers and competitors in a foreign location. (3) Efficiency seekers appear at a later stage of firm internationalization when the MNE reconfigures its existing affiliate network to gain economies of scale and scope, and hence efficiency. Although the first three types of FDI are interested in exploiting an MNE’s existing competitive advantage, (4) the fourth type aims at exploring or augmenting an MNE’s firm-specific advantages by gaining access to technology, brands, a distribution network, managerial capability, and so on (Dunning, 1993; Dunning & Lundan, 2008).

In addition to the four main types of investment motives, Dunning (1993) also identified another three types of secondary investment motives: (1) escape investments, (2) support investments, and (3) passive investments. Escape investments are triggered by “restrictive legislation or macro-organizational policies by home governments” (Dunning & Lundan, 2008: 74). For example, some U.S. MNEs in the biotechnology industry relocate their stem cell research to Europe, as it is not allowed in the United States. In empirical analysis, the push factors for outward FDI also include the high cost of conducting
domestic business compared to cross-national business (Boisot & Meyer, 2008). Meanwhile, institutional rigidity and inflexibilities are positively associated with outward FDI (OFDI) in developed countries (Witt & Lewin, 2007). Support investment covers trade-supportive investment (e.g., sales offices), finance-supportive investment (e.g., financial and hedging affiliates), and management-supportive investment (e.g., regional headquarters) (Cuervo-Cazurra & Narula, 2015).

Passive investment refers to those investments where the parent firm has “faith in the existing organisation and management of the company and is undertaken to earn profits or to gain capital appreciation” without “injecting new resources, management skills and institutional forms into the company” (Dunning & Lundan, 2008: 75). Most studies treat equity ownership level between 10% and 25% as portfolio investment (Dunning & Lundan, 2008). According to the Financial Accounting Standards Board (FASB, 1999), 20% was most commonly used as the cut-off. Here, the parent firm would not be deemed able to exert “significant influence” over its international joint venture (IJV) subsidiary if the equity level was below 20%. Based in part on this approach, Dhanaraj and Beamish (2004) rejected the common practice in IB research of treating equity investment between 5% and 95% as IJVs. They investigated the relationship between foreign equity ownership level and subsidiary mortality and found that investments with less than 20% equity ownership had very high mortality rates and those with more than 80% equity ownership had a mortality rate similar to that of a wholly owned subsidiary. Their study provided empirical support for FASB’s standard of using 20% as the cut-off point.

Dunning’s typology has been critiqued on the grounds that it fails to consider external factors (Nachum & Zaheer, 2005; Cuervo-Cazurra, Narula, & Un, 2015) or differentiate between MNEs from developed countries and emerging markets (Moghaddam, Sethi, Weber, & Wu, 2014; Luo & Tung, 2007; Morck, Yeung, & Zhao, 2008; Ramamuti, 2012). Recent developments on the typology of investment motives retained Dunning’s original emphasis on MNEs’ internal drive to expand, while adding external factors such as competitive pressure in the industry (Nachum & Zaheer, 2005) and host- and home-country effects (Cuervo-Cazurra, Narula, & Un, 2015). Nachum and Zaheer (2005) classified investment motives into six categories, including market seeking, resource
seeking, export export seeking,3, efficiency seeking, knowledge seeking, and competitive strategic motivation. The first five categories can be found in Dunning’s (1993) original typology, while the last one constitutes an MNE’s oligopolistic reaction to industry competitors. Cuervo-Cazurra, Narula, and Un (2015) combined Dunning’s (1993) concept of firm competence exploitation and augmentation with behavioral searches (Cyert & March, 1963; Simon, 1947) for better host-country conditions and avoidance of poor home-country conditions. They divided investment motives into four categories: (1) sell more; (2) buy better; (3) upgrade; and (4) escape. “Sell more” refers to MNEs exploiting existing firm capabilities and better host-country conditions, which is similar to market seeking in Dunning’s (1993) typology. “Buy better” refers to an MNE’s access to better inputs for production, which exploits existing firm capabilities and resources while escaping poor home-country conditions. It is similar to natural resource seeking in Dunning’s (1993) typology. “Upgrade” refers to augmentation of a firm’s capabilities that can be accessed in host countries, which is similar to strategic asset seeking in Dunning’s (1993) typology. “Escape” refers to the exploration of better conditions in the host country, while avoiding the constraints imposed by the home country, which is similar to “escape investment” in Dunning’s (1993) typology. Although efficiency-seeking, trade-supportive, finance-supportive, and passive investments are qualitatively different, they are all included under the category of “buy better” and “sell more” in Cuervo-Cazurra, Narula, and Un’s (2015) typology.

Moreover, efforts have been made to include the additional investment motives of EMNEs (Luo & Tung, 2007; Moghaddam, Sethi, Weber, & Wu, 2014). Luo and Tung (2007) collapsed the investment motives of EMNEs into two categories: (1) asset seeking and (2) opportunity seeking. Asset seeking covers resource seeking and strategic asset seeking. Opportunity seeking includes market seeking and focal EMNEs’ timely reaction to trade and investment polices by host and home countries. The latter form of investment

3 “Export seeking” is defined as “locating production overseas in order to serve third country market and lower production and transportation cost” (Nachum & Zaheer, 2005: 750). It is one subtype of market seeking in Dunning’s typology.
motive is not path-dependent, or evolutionary (Luo & Tung, 2007), which is different from MNEs from developed countries. Moghaddam, Sethi, Weber, and Wu (2014) modified Dunning’s original typology of investment motives and proposed a new typology from the theoretical lens of the value chain: (1) end-customer market seeking; (2) natural resource seeking; (3) knowledge seeking; (4) efficiency seeking; (5) global value chain consolidation seeking; and (6) geopolitical influence seeking. A closer examination shows that end-customer-market seeking is similar to market seeking in Dunning’s typology. Natural resource seeking and efficiency seeking (low-cost labor seeking) are similar to resource seeking. Knowledge seeking is similar to strategic asset seeking. Global value chain consolidation seeking is similar to efficiency seeking. The only newly proposed type is geopolitical influence seeking, which explains FDI behavior of an MNE from an emerging economy following the home government’s political agenda. For example, SOEs from emerging economies may have both political and social motivations, in addition to profit maximization, when they seek outward FDI (Cuervo-Cazzura, Inkpen, Musacchio, & Ramaswamy, 2014).

2.1.1.2 Multiplicity of Investment Motives

MNEs have mixed or multiple motives in their FDI (Cuervo-Cazurra & Narula, 2015; Dunning & Lundan, 2008; Getachew & Beamish, 2017). For example, an EMNE may invest in an advanced economy due to both market-seeking and strategic-asset-seeking motives (Madhok & Keyhani, 2012).

Drawing on Birkinshaw and Hood’s (1998) study on subsidiary heterogeneity and the possibility that a subsidiary has diverse investment purposes, Getachew and Beamish (2017) extended the concept of diversification from the MNE corporate level (i.e., product diversification) to the subsidiary level (i.e., investment purpose diversity), which is conducive to the learning and adaptation of a subsidiary in an adverse institutional environment. Investment purpose diversity also helps a subsidiary to reallocate resources and maintain flexibility, and hence survival.
2.1.1.3 Evolving Investment Motives

In addition to multiplicity, investment motives also evolve or change over time. Secondary motives may gain prominence over time (Cuervo-Cazurra & Narula, 2015). Qian and Delios (2008) empirically tested the idea of the changing motivation for FDI of Japanese banks that followed their clients in international expansion. They argued that as firms gained more experience in the host country, their propensity for following their clients would decrease as these firms accumulated more host-country experience. The rationale was that firms were likely to gain local market experience and change their motive from following their clients to local market seeking. However, the empirical results did not support their argument. They found that, as firms accumulate more experience in their host society, they are more likely to follow their clients in the host country to set up branch offices or subsidiaries. A three-way interaction was not included in the paper to test the hypothesis of changing motivations.

2.1.2 Empirical Measurement of Investment Motives

Previous research on investment purposes has used aggregate data to measure investment purposes, at the country level (Brouthers et al., 2008), industry level (Nachum & Zaheer, 2005), and, on a few occasions, at the firm level or subsidiary level (Chakravarty, Hsieh, Schotter, & Beamish, 2017; Getachew & Beamish, 2017; Makino, Beamish, & Zhao, 2004).

Brouthers, Gao, and McNicol (2008) used country-level data in the Foreign Direct Investment Database collected by the United Nations Conference on Trade and Development in their analysis. FDI motives were measured by industries. For example, industries such as wholesaling, retailing, transportation, storage, communications, real estate, and financial services were grouped under market-seeking FDI. Nachum and Zaheer (2005) used industry-level FDI data collected by the U.S. Bureau of Economic Analysis to measure investment motivations. For example, market seeking was operationalized by “the cost of sales of affiliates as a share of total costs” and resource seeking was measured by “local purchases by affiliates as a share of total costs.”
aggregate data is used, it violates the assumption of “multidimensionality and heterogeneity of MNE activity” (Doz & Prahalad, 1991).

Makino, Lau, and Yeh (2002), using survey data collected from MNEs in Taiwan, made the first effort to measure investment purposes at the subsidiary level. Drawing on Dunning (1993), they divided investment motives into three categories, i.e., market seeking, resource (labor) seeking, and strategic asset seeking. Respondents were asked to identify reasons for their FDI. Dummy variables were created for each motive (“1” when a respondent indicated the motive and “0” otherwise). Another study that measured investment motives at the subsidiary level was conducted by Makino, Chan, Isobe, and Beamish (2007). They used the *Trend Survey of Overseas Business Activities* by the Japanese Ministry of Economy, Trade and Industry, which is an annual survey conducted on Japanese foreign affiliates across the world. The original dataset listed seven investment objectives for a subsidiary, including “the procurement of raw and natural resources, access to low-cost inputs, following customers, market expansion, the transfer of dividends and earned loyalty, hedging against exchange rate risk, and research and development” (p. 1121). These seven objectives were classified into four categories in the final analysis: resource/labor seeking, market seeking, capital seeking, and strategic asset seeking.

Although information on investment motives has been included in subsequent surveys, the most comprehensive listings of subsidiary-level investment purposes are those studies using the TK dataset (Chakravarty et al., 2017; Getachew & Beamish, 2017; Makino et al., 2004), which classified investment motives into 16 categories, specifically (1) access to natural resources, (2) access to a labor force, (3) invitation from the local government, (4) establishment of a production network, (5) establishment of a distribution network, (6) access to a local market, (7) import to a third-country, (8) import back to Japan, (9) follow the customers/the affiliated company; (10) hedging against exchange rate risks,

4 Section 2.1.3 covers previous research on investment motives, where survey data on investment motives have been collected.
(11) information collection, (12) product development and planning, (13) entry into new business, (14) regional HQ, (15) measures against trade frictions, and (16) others. Makino et al. (2004) used the original coding in the dataset in their analysis of investment purposes and location choices, while Chakravarty et al. (2017) followed Dunning’s (1993) classification of investment motives and divided investment purposes into five categories based on the original coding, including market seeking, resource seeking, efficiency seeking, strategic asset seeking, and capital seeking. Getachew and Beamish (2017) went a step further to generate a new variable for investment purpose diversity.

2.1.3 Previous Research on Investment Motives

Subsidiaries (or FDI projects) are heterogeneous due to their differences in investment motives (Beugelsdijk et al., 2010). A key theme of this dissertation is that they have different characteristics (such as mode choice, expatriation policy, location choice, etc.) and performance (such as financial and non-financial performance, termination, etc.). They have access to different resources and are under varying levels of pressure both within their MNE network and in their interaction with host countries.

With different investment motives, subsidiaries differ in their entry-mode choices (Cui & Jiang, 2009; Pan, 2017; Yu, Lee, & Han, 2015), staffing and expatriate policy (Paik & Ando, 2011), location choice (Galan, Gonzalez-Benito, & Zuniga-Vincente, 2007; Goerzen, Asmussen, & Nielsen, 2013; Lei & Chen, 2011; Makino, Lau, & Yeh, 2002; Makino et al., 2004), performance (Hansen & Gwozdz, 2015; Luo & Bu, 2017; Yang, Yang, & Doyle, 2013), and termination (Getachew & Beamish, 2017; Makino et al., 2007). This section covers the following five topics: (1) entry-mode choice; (2) staffing and expatriate policy; (3) location choice; (4) performance; and (5) termination. While all these topics have been previously covered in the literature, special attention is paid to how they differ according to investment motives.

2.1.3.1 Entry-Mode Choices

The literature on investment motives and entry-mode choices has covered market-seeking behavior (Aulakh & Kotabe, 1997; Gil, Nakos, Brouthers, & Brouthers, 2006; Yu et al., 2015), resource-seeking behavior (Gil et al., 2006; Yu et al., 2015), following-the-client
behavior (Erramilli & Rao, 1990; Gil et al., 2006), and strategic-asset-seeking behavior (Cui & Jiang, 2009). Moreover, the institutional environment of host countries has been used as a moderator in some analyses (Yu et al., 2016; Pan, 2017). In our review, entry-mode choice is limited to the decision of establishing a WOS or an IJV.

First, the relationship between the investment motive of market seeking and entry-mode choice is not conclusive in the existing literature. One school of thought draws from the transaction cost economics (TCE) perspective (Brouthers & Hennart, 2007) and argues that MNEs try to protect their own firm-specific assets or advantages such as proprietary technology and brands. Thus, they would prefer WOSs over IJVs due to concerns of possible opportunistic behavior by JV partners, especially leakage of know-how (Anderson & Gatignon, 1986). Another school argues that MNEs would prefer IJVs over WOSs in order to have access to a local partner’s complementary assets (Beamish & Banks, 1987) or to provide an incentive to a local partner through shared ownership (Yu et al., 2015).

Empirical results have found evidence for all three options, i.e., preference for WOSs, preference or IJVs, or no preference. Drawing from the survey results of 108 informants from Fortune 500 firms, Aulakh and Kotabe (1997) found that market-seeking intention had no effect on the choice between a WOS or an IJV. One critique of this research is that the location of their FDI was not disclosed in the study. Gil et al. (2006) found that MNEs prefer to establish a WOS affiliate when pursuing a market-seeking strategy in Central and Eastern European (CEE) countries when there are few local partners in their industry. However, in a recent study by Yu et al. (2015), it was found that market-seeking MNEs prefer to establish an IJV in Southeast Asian countries such as Thailand and Malaysia because MNEs rely on local partners to establish local distribution channels. The effect was even stronger in host societies with better market governance or more favorable institutional environments as measured by political stability, government effectiveness, regulatory quality, the rule of law, the control of corruption, etc. One possible explanation is that MNEs are less worried about the local partner’s opportunistic behavior in a favorable host institutional environment and are willing to provide more of an incentive to a local partner to exert efforts in seeking customers.
Second, MNEs engaged in resource-seeking FDI are likely to adopt an IJV as an entry mode over a WOS (Gil et al., 2006; Yu et al., 2015). Although resource-seeking FDI is usually vertically integrated, MNEs engaged in resource-seeking FDI export their output to other affiliates within their MNE network, which requires more coordination among different affiliates and tighter control of the focal subsidiary (Kim & Hwang, 1992). Following this logic, a WOS would be preferred over an IJV in resource-seeking FDI. However, empirical research results show the opposite, in the context of both CEE countries and Southeast Asian countries (Gil et al., 2006; Yu et al., 2015). Because these host countries have less developed market governance structures, MNEs prefer to use an IJV in order to provide incentives to local partners to navigate the local business environment and find the right suppliers and resources (Yu et al., 2015). Moreover, under more favorable host-country institutional environments, MNEs’ preference for an IJV over a WOS is weakened because the relative importance of local partners is diminished and there is less need to provide an incentive to local partners.

In addition to resource-seeking FDI, following the client is another category that has been studied. Many service firms have expanded internationally to provide service to their existing customers, which is qualitatively different from manufacturing FDI seeking local market access (Erramilli & Rao, 1990). From a survey of 175 U.S. service firms undertaking international expansion, Erramilli and Rao (1990) found that subsidiaries with the investment purpose of following the client preferred to have a higher ownership level in their affiliates compared with market-seeking subsidiaries, because local knowledge was not highly valued in following-the-client FDI.

Finally, as EMNEs are engaged in FDI for the purpose of strategic asset seeking, they usually prefer a WOS over an IJV (Cui & Jiang, 2009) because strategic assets such as technology, brands, and distribution channels cannot be fully accessed through an IJV (Rui & Yip, 2008). From a survey of 138 Chinese firms, Cui and Jiang (2009) found that firms with a strategic-asset-seeking motivation were 2.66 times more likely to use a WOS as the entry mode compared with firms that were not strategic asset seeking.
In sum, most existing research on the relationship between investment motives and entry-mode choice (including ownership level) covers market-seeking, resource-seeking, following-the-client, and strategic-asset-seeking FDI. Little is known about the mode of choice for FDI with such investment motives as efficiency seeking and those with support functions.

2.1.3.2 Staffing and Expatriate Policy

Expatriates have two primary functions: control and knowledge management (Delios & Bjorkman, 2000). In addition, expatriates also fulfill the role of being an ambassador, i.e., managing multiple stakeholders at home and in host societies (Peng & Meyer, 2016).

First, when there is a strong need for the MNE headquarters to control its subsidiaries, MNEs will send expats to the affiliate to align the operations. Meanwhile, if there is a greater risk involved in the operations of subsidiaries, MNEs will send more expats as well. For example, when there is a greater institutional distance between the host and home countries, the need for control is stronger in an unfamiliar environment. As a result, more expats will be sent to subsidiaries (Gaur, Delios, & Singh, 2007). Second, expats also fulfill the role of knowledge transfer, i.e., they transfer knowledge and practices from the MNE headquarters to the affiliate. For example, in the service industry, when close contact with end customers and high levels of professional skills are needed, expats are preferred over local staff (Bouquet, Hebert, & Delios, 2004). When an MNE is engaged in strategic-asset-seeking or knowledge-seeking FDI, expatriates are sent to subsidiaries for reverse knowledge transfer (Delios & Bjorkman, 2000). Third, in addition to the roles played by expats, the availability of experienced expats and remuneration policies for expats also have an impact on expat policy (Widmier, Brouthers, & Beamish, 2008). For example, MNEs with more global FDI experience are staffed with more experienced expats and are more likely to send expats abroad than less experienced MNEs. However, as an MNE gains more host-country experience, its need for expats diminishes, as local managers make good business sense and the increased input from local managers improves profitability (Beamish & Inkpen, 1998).

With regard to the relationship between investment purpose and expat policy, only one study (Paik & Ando, 2011) has been identified that investigated this relationship. They
analyzed a cross-sectional TK dataset in 2008 to investigate the relationship between investment motives and the use of expats as measured by the ratio of expats to local employees. The investment motives were classified into two categories: (1) global integration and (2) local market seeking. If affiliates are self-contained profit centers, their objectives might differ from those of MNEs (Dunning & Lundan, 2008). It was hypothesized that affiliates with a global integration mandate would be more likely to use expats because expats were sent to strictly follow the orders of the headquarters so as to align the interests of the headquarters and the affiliates. Nonetheless, it was affiliates with a global integration motive that had a lower proportion of expats. One possible explanation is that these were mature MNEs with a lot of international experience and they had trained local managers who were as good as expats in interest alignment. The proportion of expats in foreign affiliates was even lower when the parent MNEs accumulated more international experience. The rationale was that as MNEs had more experience in international operations, they would have more experience in international coordination and rely less on expats to carry out global integration.

However, in local-market-seeking affiliates, MNEs tend to staff less with expats, as local managers have more knowledge of the local market and have better access to local resources compared with expats. That line of logic gained empirical support by Paik and Ando. As an MNE accumulates more experience in the host country, it will be even less likely to send expats to the affiliates as they gain more confidence in monitoring the behavior of local managers, and in handling the internal and external uncertainty in the local environment.

Paik and Ando (2011) contribute to our understanding of the impact of investment purposes on expatriate staffing policies. Nonetheless, their research has several limitations. First, it collapsed investment purposes into two categories: global integration and local market seeking. In fact, there are other motives for affiliates. Second, only cross-sectional data in 2008 was used in their analysis, which helps to explain their contradictory finding versus the original hypothesis. A larger dataset with a longer timeframe might be able to alleviate this problem.
2.1.3.3 Location Choice

Location is a key decision for an MNE to make when contemplating international expansion. There is a huge literature on location choice in international business (e.g., Beugelsdijk & Mudambi, 2013; Dunning, 1998). This section is limited to the literature and empirical studies that directly link investment motives and location choice. The investment motives of an MNE have a direct impact on its location choice. Most existing literature linking investment motives and location choice has treated location choice as a dichotomous variable, e.g., developed countries versus less developed countries (Makino et al., 2002; Makino et al., 2004), European Union versus Latin America (Galan et al., 2007), developed regions versus less developed regions, e.g., China versus Vietnam, and East China versus South China (Lei & Chen, 2011). The main theoretical lens is asset exploitation and asset seeking. Asset-exploiting FDI is defined as “the transfer of a firm’s proprietary assets across borders,” while asset-seeking FDI is defined as “a means to acquire strategic assets (i.e., technology, marketing and management expertise) available in a host country” (Makino et al., 2002: 404).

In empirical research, strategic-asset-seeking FDI is classified as asset seeking, while market-seeking FDI is classified as asset exploitation. First, as strategic assets are more likely to be located in developed countries or regions, asset-seeking FDI is more likely to be located in developed countries than in less developed countries. Empirical results show consistent support (Lei & Chen, 2011; Makino et al., 2002; Makino et al., 2004; Galan et al., 2007). Second, resource-seeking FDI is mainly interested in acquiring resources such as labor and natural resources in a host country at a lower real cost than the cost in the home country (Dunning, 1993). As it is easier to obtain low-cost resources in less developed countries than in developed countries, it was hypothesized that resource-seeking FDI is more likely to be found in less developed countries than in developed countries (e.g., Makino et al., 2002; Makino et al., 2004; Galan et al., 2007). However, empirical analysis showed conflicting results. The hypothesis was supported in the context of Taiwanese and Japanese MNEs’ overseas investment (e.g., Makino et al., 2002; Makino et al., 2004), but was negatively related to Spanish MNEs’ investment in Latin America versus the European Union (Galan et al., 2007). One possible explanation
is that Latin American countries had poor transportation infrastructure despite richness in natural resources. As a result, Spanish MNEs had to incur a high cost for transportation and logistics expenses, which offset the cost savings in natural resources. Another commonly used asset-exploitation motive is market seeking. It was argued that developed countries have a higher market potential than less developed countries. As a result, market-seeking FDI is more likely to be located in developed countries than less developed countries (Makino et al., 2002). This line of reasoning has had mixed empirical results. Makino et al. (2004) found that market-seeking motivation was the highest ranked motivation in both developed (66.8%) and less developed countries (62.6%). One possible explanation for the popularity of market-seeking FDI in both developed and less developed countries is that MNEs can use a differentiation strategy in developed countries and use a cost-reduction strategy in less developed ones (Makino et al., 2002). Nonetheless, Galan et al. (2007) found that market seeking was irrelevant in Spanish MNEs’ choice of the European Union over Latin America.

Another location decision is global cities versus non-global cities (Goerzen, Asmussen, & Nielsen, 2013). Global cities are characterized by “a high degree of interconnectedness to local and global markets; a cosmopolitan environment; and high levels of advanced producer services” (Goerzen et al., 2013: 430). An MNE’s decision to locate a subsidiary in a global city versus a non-global city has been analyzed through the theoretical lens of “competence-exploiting” versus “competence-creating” (Cantwell & Mudambi, 2005, 2011). “Competence-exploiting” units are “demand driven with a focus on market servicing,” while “competence-creating” units are “supply driven with a focus on enhancing production and research and development competencies” (Goerzen et al., 2013: 433). According to this definition, market-seeking FDI is classified as competence-exploiting, while strategic asset seeking, resource seeking, and efficiency seeking are classified as competence-creating. It was hypothesized that market-seeking FDI is more likely to be located in global cities because there is a liability-of-foreignness-reducing effect of global cities due to their cosmopolitan culture. Meanwhile, MNEs are more likely to locate production and R&D facilities in non-global cities than global cities due to the cost of place and concern over technology spillover to competitors. Using a cross-
sectional TK dataset in 2001, this hypothesis received empirical support (Goerzen et al., 2013).

Moreover, investment motives have been used as moderators in at least two location-choice studies (e.g., Jiang, Holburn, & Beamish, 2018; Schotter & Beamish, 2013). Jiang et al. (2018) found that horizontal investment motives (such as market-seeking FDI) have a negative moderating effect on repeated entry in a host country due to internal competition and a possible cannibalization effect, while vertical investment motives (such as resource-seeking FDI) have a positive moderating effect because these subsidiaries provide complementary assets to each other. Schotter and Beamish (2013) analyzed how a manager’s personal perception of a country, i.e., the hassle factor, leads to location shunning in an MNE’s decision making. They found that the hassle factor negatively moderates the relationship between a country’s FDI potential and an MNE’s FDI intensity. However, the moderated relationship is weaker if the investment motive is natural resource seeking, as natural resources are location-immobile.

2.1.3.4 Performance

Performance is a multidimensional measure that covers both subjective and objective measures including accounting data, financial market reaction, reputation or perception of growth, sales, profitability, survival, etc. (Richard et al., 2009). The performance outcome for FDI is contingent upon its investment motivations (Benito, 2015; Verbeke & Brugman, 2009; Verbeke, Li, & Goerzen, 2009; Verbeke & Forootan, 2012). Parent MNEs will assign different roles to affiliates, and resource transfer between the parent firm and affiliates will vary due to differences in investment motives, which is critical for subsidiary performance (Verbeke et al., 2009). Meanwhile, different types of FDI have corresponding performance objectives and time horizons to realize those objectives. For example, value-chain cost saving will be the main objective for vertical FDI, while revenue generation will be the main concern for horizontal FDI (Verbeke et al., 2009). In strategic-asset-seeking FDI, parent firms have a long horizon to achieve the goal of realizing their objective, which is not instantly achievable (Yang, Yang, & Doyle, 2013). As a result, it is insufficient to measure performance without taking into consideration the investment motives. However, most empirical research studies on performance have not
included investment motives in their analyses, with a few exceptions (e.g., Hansen & Gwozdz, 2015; Luo & Bu, 2017; Yang et al., 2013).

In empirical research, both parent MNE firm performance and subsidiary performance have been measured. MNE performance has been subjectively assessed by such measures as international marketing performance according to a 7-point Likert scale (Luo & Bu, 2017). It has also been objectively measured by stock market reaction to parent firms engaged in FDI, such as cumulative abnormal returns (Yang et al., 2013). With regard to subsidiary performance, multiple measures have been used, including financial (internal rate of return, or IRR), operational (premature stop of operations, or PSO), and organizational (manager’s subjective assessment of subsidiary performance, or MP) measures (Hansen & Gwozdz, 2015). The use of multiple measures of subsidiary performance will overcome the pitfall of using sales and profit as an indicator of performance because, in non-market-seeking FDI, subsidiaries might have the mandate of being a low-cost production base, which helps the parent MNE to integrate its global value chain and achieve transfer pricing and profitability (Luo, 2003).

With regard to the main effect of investment motives on subsidiary performance outcome, efficiency-seeking FDI has a better survival outcome compared to FDI with other motivations including local market seeking and resource (labor) seeking (Hansen & Gwozdz, 2015). It has been argued that an efficiency-seeking subsidiary is a key part of the value chain and that the parent MNE is more likely to provide additional resources to prevent it from exiting in times of crisis compared with subsidiaries founded on the basis of other investment motives. However, there is no difference among subsidiaries with different investment motives when a financial measure (IRR) or managerial assessment of subsidiary performance is used. Nonetheless, only four types of subsidiaries are included in the analysis: local market seeking, efficiency seeking, resource seeking, and other (Hansen & Gwozdz, 2015).

Moreover, strategic-asset-seeking FDI has been tested as a moderator of the relationship between foreign investment and performance outcome for parent MNEs. When a subjective MNE performance measure is used, strategic asset seeking has a positive
moderating effect on the relationship between foreign investment and MNE performance outcome because strategic-asset-seeking FDI is intended to improve the resource portfolio, which will help the parent MNE’s performance in the long run (Luo & Bu, 2017). Using surveys of Chinese executives of MNEs engaged in FDI between 2009 and 2012, Luo and Bu (2017) found that a strategic-asset-seeking motivation enhanced the positive impact of foreign investment on international customer breadth for the parent MNE. Nonetheless, when short-term stock-market reaction was used as a measure of MNE performance, strategic-asset-seeking motivation negatively moderated the relationship between foreign investment projects and MNE performance. Using a sample of 121 FDI projects initiated by 102 Chinese listed companies between 2001 and 2009, Yang et al. (2013) found that strategic-asset FDI project announcements produced lower cumulative abnormal returns (CAR) for Chinese listed companies than traditional FDI projects. It has been argued that most Chinese MNEs engaged in strategic-asset-seeking FDI have a low absorptive capacity (Cohen & Levinthal, 1990) or recombination capability (Rugman, 2010) to combine acquired strategic assets (such as technology, brand, and reputation) with existing firm resources to create value for the parent MNE in the short run. This helps explain the short-term negative stock-market reaction to strategic-asset-seeking FDI.

2.1.3.5 Termination

In terms of the relationship between initial investment motives and the termination of affiliates, Makino et al. (2007) investigated the impact of initial investment motives on intended terminations and unintended terminations. Here, termination is defined as complete termination, i.e., the affiliate is closed, not a mode change or product strategy change. Investment purposes are classified in four categories: resource/labor seeking, market seeking, capital seeking, and strategic asset seeking. It was found that there was a much higher termination rate (close to 30%) for affiliates with the purpose of strategic asset seeking compared to affiliates in any of the other three categories (around 7%) in IJVs. It was argued that once an MNE acquired such strategic assets as proprietary technology and management know-how, the affiliates were likely to be terminated because local partners could not provide more value or resources to the MNE. However,
in the case of resource/labor/market/capital-seeking IJVs, resources, labor, or capital provided by local partners were continuously valued. As a result, MNEs did not terminate those IJVs. Survey results of Japanese overseas affiliates between 1996 and 2001 provided empirical support. Mode choice, i.e., IJV versus WOS, moderated the relationship between initial investment motives and intended termination. For strategic-asset-seeking investments, the termination rate of WOSs (3.2%) during the study period was much lower than that of IJVs (28.6%), because once an MNE has finished acquiring strategic assets, it will exit the IJV, as it will not be able to provide further value or resources to the MNE.

Getachew and Beamish (2017) paid special attention to the host-country context and investigated how the relationship between host-country institutional environment and subsidiary exit is moderated by investment motives. Slangen and Beugelsdijk (2010) argued that horizontal FDI, such as market-seeking FDI, operates more independently from its parent and sister affiliates and is more embedded in the host environment. Vertical FDI is more tightly integrated with the global MNE network and has less autonomy than horizontal FDI. Following this line of logic, Getachew and Beamish (2017) operationalized horizontal FDI as market-seeking FDI. Using a matched sample of FDI in African and OECD countries, they found no relationship between market-seeking orientation and exit. FDI in Africa, a region characterized by high institutional voids and institutional instability, had a higher subsidiary exit rate that FDI in OECD countries. The relationship between entry to Africa and exit was weakened by market-seeking orientation, because horizontal FDI is more embedded in the host environment and operates rather independently. As a result, the parent firm had a higher tolerance for horizontal FDI to stay in host countries with institutional voids and instability compared with vertical FDI. Moreover, investment purpose diversity also weakened the relationship between entry to Africa and subsidiary exit, because affiliates with diverse investment purposes could explore and learn more about the local environment with more flexibility in a host environment with institutional voids, thus mitigating the hazards of doing business in adverse host societies. However, investment purpose diversity did not have a direct impact on subsidiary exit.
In sum, two types of categorization exist in the previous literature regarding investment purpose and exit, i.e., asset exploitation versus asset augmentation (Makino et al., 2007) and horizontal versus vertical FDI (Getachew & Beamish, 2017; Slangen & Beugelsdijk, 2010). The relationship between investment purpose and exit is not conclusive.

2.2 Theoretical Framework

The theoretical framework of this chapter (see Figure A) is rooted in the OLI paradigm (Dunning, 1988; Dunning 1993; Dunning & Lundan, 2008), where the interaction of an MNE’s ownership advantages (O-advantages) with the location advantages (L-advantages) of host and home countries jointly determines the investment motive(s) of an affiliate (Cuervo-Cazurra & Narula, 2015; Narula, 2012; Meyer et al., 2011). Unlike the existing literature on the OLI paradigm which uses the umbrella term of country specific advantages (CSAs), we differentiate between host country specific advantages (host CSAs) and home country specific advantages (home CSAs). Once an MNE decides on the strategic investment motives for an affiliate, the central aspects of its internationalization such as mode choice (WOS versus IJV), expatriate deployment, and size are differentiated in a systematic manner (Benito, 2015). Meanwhile, internalization theory (e.g., Caves, 1971; Buckley & Casson, 1976; Rugman, 1981; Hennart, 1982) has been used to explain the mode choice between WOS and IJV. The particular market failures identified in our analysis are asset specificity and information asymmetry. Moreover, the theory of investment development path (Narula & Dunning, 2000) has been applied to discuss host-country conditions. Four hypotheses have been developed to further explain this model.

2.2.1 Ownership Advantages and Investment Motives

Ownership advantages (O-advantages) are transferrable firm-specific assets that are capable of generating economic rent and creating a competitive advantage for the focal MNE in foreign direct investments (Narula, 2010). There are two types of O-advantages: asset-type (Oi) and transaction-type (Ot) (Dunning & Lundan, 2008). Asset-type ownership advantages include management know-how, proprietary knowledge, the knowledge to manage multi-location businesses, etc. Transaction-type ownership
advantages derive from the ability of the firm to organize efficient internal hierarchies and utilize external markets. Examples include operational manuals and codes of conduct.

When MNEs are engaged in FDI, the availability of investment motives is bounded or constrained by their existing ownership advantages or firm-specific advantages. An MNE’s proprietary knowledge, marketing capabilities, capital, and years of international experience will be used to illustrate this point.

First, if an MNE possesses superior proprietary technology and marketing capabilities, it has the options of market-seeking and natural-resource-seeking FDI, among others. Due to the transferability of proprietary knowledge and marketing capabilities, an MNE can position itself either as a differentiator or a cost-leader in the host market and can derive superior economic rent from those capabilities. In the case of natural resource seeking, especially in the oil and mining industries, an MNE’s possession of extractive technology is necessary for it to be involved in natural-resource-seeking FDI.

Second, an MNE that possesses substantial capital may be engaged in natural-resource-seeking, market-seeking, or strategic-asset-seeking FDI. It may go to a low-labor-cost country to set up factories to lower its production costs, while at the same time seeking access to local markets. It may also enter an extractive business where a huge investment is required upfront. In terms of strategic-asset-seeking FDI, MNEs from emerging economies that are technological laggards, and yet possess significant capital, are likely to conduct FDI to acquire strategic assets such as management know-how, proprietary technology, and distribution networks (Luo & Tung, 2007, 2018).

Third, an MNE’s FDI experience may also affect its motives. An MNE with limited experience in FDI is more likely to have supportive investment motives, such as information collection, at the early stage of internationalization, which will help it to further develop its footprint in the host country. As an MNE accumulates more

5 In this chapter, ownership advantages and firm-specific advantages are used interchangeably.
experience in FDI, it may have multiple production locations, R&D centers, or distribution centers. To achieve economies of scale and scope, it may seek efficiency-seeking FDI by rationalizing its production and distribution network. It may also establish subsidiaries for such support functions as regional management centers to achieve a better result in global integration and local responsiveness (Chakravarty et al., 2017; Schotter, 2017). Hence, we provide the first hypothesis:

**Hypothesis 1:** There is a relationship between an MNE’s ownership advantages and the investment motives of its overseas affiliates.

### 2.2.2 Location Advantages and Investment Motives

In this section, we distinguish between two types of location-specific advantages, i.e., host-country-specific advantages and home-country-specific (dis)advantages. Host-country advantages have a direct impact on the investment motives of MNEs. Home-country advantages have a mediating effect on investment motives through ownership advantages. Meanwhile, home-country advantages also have a direct effect on investment motives while interacting with host-country advantages to influence investment motives.

#### 2.2.2.1 Host-Country-Specific Advantages and Investment Motives

Due to the liability of foreignness (Zaheer, 1995) for MNEs conducting business abroad, foreign locations must be able to offer advantages and attract MNEs to do business (Buckley & Hashai, 2004; Dunning, 1998). There are four types of locational advantages: markets, natural resources, agglomeration, and institutions (Dunning, 1993; Dunning & Lundan, 2008; Narula & Santangelo, 2012; Peng & Meyer, 2016). Market advantages refer to the population density and purchasing power of the local population. Natural resource advantages refer to the natural endowment in a location, including natural resources, low-cost labor, human capital, and infrastructure. Agglomeration advantages refer to the clusters of related businesses or the collocation of businesses (Narula & Santangelo, 2012) with the advantage of knowledge spillover, a skilled labor force within the region, and a pool of specialized buyers and suppliers (Kalnins & Chung, 2004; Nachum, 2000). Institutions advantages refer to the institutional environment, such as culture, norms, legal and financial infrastructure, regulations and policy, and so on.
Locational advantages are in principle public goods, but this is not always the case. For example, while universities and research facilities are publicly available, certain locational advantages are internalized as firm-specific assets and are not publicly available. That is why local embeddedness matters to foreign investors who wish to have full access to the resource advantages of a particular location (Meyer et al., 2011).

In the process of internationalization, an MNE attempts to utilize its ownership advantages in conjunction with location-specific assets (Cuervo-Cazurra & Narula, 2015). The possible options for investment motives are contingent upon the availability of certain types of locational advantages that MNEs have in mind during the internationalization process. Meanwhile, the investment development path theory predicts that the developmental stage of a host country also attracts specific types of investment (Narula & Dunning, 2000). For example, for countries at an early stage of development, inward FDI outnumbers outward FDI and they mainly attract natural-resource-seeking and market-seeking FDI. When host countries are at a higher level of development, outward FDI exceeds inward FDI and they mainly attract strategic-asset-seeking FDI and, to a lesser extent, market-seeking or resource-seeking FDI. As countries can progress from one stage to another, it is difficult to put them into a specific category and predict their inward FDI. As a result, the following discussion will focus on the specific locational advantages of host countries and their predictive power for specific investments.

First, for market-seeking investments, population size and the purchasing power of a location are the main factors for consideration (Benito, 2015). Due to the costs and risks involved in FDI, proximity also matters, especially for firms at an early stage of internationalization (Johanson & Vahlne, 1977). The tax incentives of the local government also provide incentives for market-seeking FDI.

Second, natural-resource-seeking FDI is constrained by the location of available resources. For example, if an MNE is interested in oil exploration, there are only a limited amount of oil fields in the world to choose from. Meanwhile, due to the cost of
transporting resources, local transportation infrastructure is also a factor for consideration (Galan et al., 2007). If the motive is to access local labor, then the cost of local labor and the amount of cheap labor available are the main factors for consideration.

Third, with regard to efficiency-seeking FDI, the cost of labor matters for those MNEs that seek to rationalize their production network. Because long distances will lead to higher transportation costs and management costs, proximity among affiliates is also a factor for consideration for efficiency-seeking FDI (Benito, 2015).

Fourth, for strategic-asset-seeking FDI, as developed countries are more likely to have such strategic assets as proprietary knowledge, global distribution networks, and management know-how, an MNE is more likely to choose developed countries over developing countries (Makino et al., 2004). Within developed countries, industrial clusters are likely to be chosen over non-clustered areas due to consideration over knowledge spillover and connections with suppliers and distributors (Narula & Santangelo, 2012. Hence, we present the second hypothesis:

**Hypothesis 2a:** There is a relationship between an MNE’s host-country location advantages and the investment motives of its overseas affiliates.

### 2.2.2.2 Home-Country Advantages, and Ownership Advantages

The home-country location advantage (L) determines the initial ownership advantage of domestic firms (Cuervo-Cazurra et al., 2018; Hobdari et al., 2017; Narula, 2012). To be specific, the L advantage determines the amount and type of initial O advantage or resource munificence of domestic firms. For illustration purposes, there are three types of countries: low-income developing countries (LDCs), emerging economies, and advanced, developed countries. LDCs are characterized by institutional voids and poor legal and market infrastructure, and firms from these countries are endowed with little initial O advantages to be able to engage in any significant economic activity, including firm internationalization. Due to limited inward FDI and little linkage with the global economy, there is little chance for these firms to augment their O advantages by learning
from MNEs from other countries. As a result, there are few firms with O advantages except in the extractive industry.

Second, for those firms from emerging economies, the initial O advantage is still a function of the L assets. However, due to its connection with the global economy and being part of the global value chain—plus the collocation advantage (Narula & Santangelo, 2012) resulting from the substantial inward FDI in those countries—these firms are able to augment their O advantages through knowledge transfer from MNEs from advanced economies. As a result, the O advantage of domestic firms from emerging economies goes beyond the L advantage of the home countries by having more breadth. However, these firms lack resources in term of technology, finances, and human capital (Awate et al., 2012). Compared with developed-country MNEs, they are technology laggards, face financial constraints, and lack highly qualified management personal in firm internationalization. Nonetheless, due to their capability to deal with imperfect institutions at home, they might be able to develop capabilities that will help them to operate in other emerging economies through institutional learning (Cuervo-Cazurra et al., 2018).

Third, for firms from advanced economies, they are endowed with better institutional and market infrastructure. Most of them are knowledge-intensive firms and deeply embedded within the global value chain. These firms have better organizational skills to achieve knowledge transfer. In other words, there are more L advantages for domestic firms to internalize in advanced economies and they have better organizational skills to internalize those L advantages.

In summary, the more advanced the home country is, the more the L advantage for an MNE to internalize as an O advantage (Narula, 2012). Hence, we propose the following hypothesis:

Hypothesis 2b: The more advanced the home country, the greater the initial O advantage possessed by an MNE from that country.
2.2.2.3 Impact of Home-Country (Dis)advantages on Investment Motives

Most literature on the impact of home-country (dis)advantages on firm internationalization treats it as a push factor for outward FDI. First, if the population size is small in the home country, then there is a limited domestic market, which may act as a push factor for firms to internationalize. MNEs from Scandinavian countries fall into this category. Second, when the home country is going through rapid industrialization, it may need resources for industrial input. For example, investments of MNEs from China and India in Africa may seek resources to satisfy the needs of domestic industrial development. Third, when there is a competitive domestic market with both domestic and foreign players, MNEs may seek strategic-asset-seeking investment abroad to augment their capabilities (Cuervo-Cazurra et al., 2018).

Fourth, the vast majority of literature on home-country conditions and investment motives focuses on escape investment (Cuervo-Cazurra et al., 2015; Barnard & Luiz, 2018; Boisot & Meyer, 2008; Fathallah et al., 2018; Kobrak et al., 2018; Shi et al., 2017; Witt & Lewin, 2007). MNEs may conduct escape investment to “avoid the poor conditions of the home country” (Cuervo-Cazurra et al., 2015: 32), that is, problematic conditions that would add costs to firm operations. For example, because the cost of doing business domestically exceeded the cost of doing business internationally and there was better protection of intellectual property rights in Western countries than in domestic markets, Chinese firms chose OFDI to escape “weak institutions” in their home country (Boisot & Meyer, 2008). When different dimensions of institutions are not progressing at the same time, internal frictions and conflicts arise. This results in institutional fragility, which also acts as a push factor for OFDI (Shi et al., 2017).

In developed countries, it is not “weak institutions” per se, but the “ossification of institutions,” such as taxes and high social contribution, which may act as a push factor for MNEs to invest abroad (Witt & Lewin, 2007). In their study, Witt and Lewin (2007)
found a positive association between Societal Coordination Index (SCI)\(^6\) score and outward FDI. Nonetheless, a later study (Kobrak et al., 2018) showed that SCI score was not only positively related to outward FDI, but also positively related to inward FDI. This means that a stable and elaborated institutional environment not only promotes outward investment, but also attracts inward investment. High labor costs in the home country have been found to have a similar effect on OFDI in the IT industry (Weng & Peng, 2018). Moreover, there is a time dimension to escape FDI. For example, Barnard and Luiz (2018) argued that there was a cumulative process of institutional misalignment and contestation in South Africa’s OFDI that spanned from 1956 to 2012. Escape FDI could also occur in less than a decade in hyper-turbulent home contexts such as Lebanon, where wars forced domestic firms to invest abroad (Fathallah et al., 2018). Hence, we propose the following hypothesis:

**Hypothesis 2c:** There is a relationship between home-country (dis)advantages and the investment motives of MNEs.

### 2.2.2.4 Joint Impact of Home- and Host-Country (Dis)advantages on Investment Motives

The literature on the joint effects of home and host countries on firm internationalization mainly draws from the theoretical lens of “institutional arbitrage” (Mingo, Junkunc, & Morales, 2018). Early literature on home–host country differences focused on institutional differences between the home and host countries, such as the cultural distance between host and home countries (Kogut & Singh, 1988), the difference between the regulatory institutions between home and host countries (Henisz & Delios, 2000), and so on. It has been argued that the larger the distance, the more difficult it is for MNEs to operate and to transfer knowledge and skills from the home to host countries (Kostova, 1999). Thus, the larger the institutional distance between the host and home countries, the less likely that an MNE will invest in the host country and the more difficult it will be for an MNE if it chooses to operate in that host country.

\(^6\) The SCI score measures the importance of coordination in an economy.
Nonetheless, recent studies found that the relationship between institutional distance between home and host countries and the likelihood of firm internationalization can also be curvilinear. Using private equity (PE) investments in Latin America between 1996 and 2011, Mingo et al. (2018) found that a strong institutional environment in the host country attracted PE projects from PE firms of home countries with both strong and weak institutions. Meanwhile, weak institutional environments in the host countries deterred PE projects from PE firms from both strong and weak institutional environments. Moreover, different actors from the same home country may react differently to the same institutional distance between home and host countries. For example, Chinese SOEs face greater legitimacy challenges investing abroad than private Chinese MNEs do (Li et al., 2018). As a result, SOEs are less likely to conduct OFDI compared with private firms.

We propose that home- and host-country (dis)advantages have a joint impact on investment motives. When a firm contemplates what type of FDI to engage in, it simultaneously considers home- and host-country (dis)advantages. For example, Cuervo-Cazurra, Narula, and Un (2015) argued that MNEs simultaneously seek favorable host-country conditions and avoid poor home-country conditions in firm internalization. By collapsing investment motives into four categories—“sell more” (i.e., market seeking), “buy better” (i.e., natural resource seeking), “upgrade” (i.e., strategic asset seeking), and “escape” (i.e., escape investment)—they argued that firms would be motivated to “sell more” and “upgrade” to obtain better host-country conditions. It was also argued that MNEs would be motivated to “buy better” and “escape” to avoid poor home-country conditions. Moreover, firms could also be motivated to simultaneously “buy better” and “sell more” (such as efficiency seeking). Hence, we propose the following hypothesis:

**Hypothesis 2d:** There is a relationship between the institutional arbitrage of host versus home countries and the investment motives of MNEs.

### 2.2.3 Investment Motives and Mode Choices

The choice of operation mode is a central aspect of firm internationalization. It refers to organizational arrangements such as exporting, licensing, WOSs, and IJVs. The operational mode may also change over time (Benito, Peterson, & Welch, 2009). The
major relevant theoretical framework is internalization theory (Buckley & Casson, 1976), where the major market failures identified are asset specificity and information content. In this section, only the choice between WOSs and IJVs is discussed, which is viewed in a spectrum between hierarchy and market (Buckley & Casson, 1996), i.e., WOSs are closer to hierarchy and IJVs are closer to market.

First, for market-seeking FDI, a key driver of its overseas expansion is proprietary technology and resources such as brands and trademarks. The main market failure in this case is information content or information asymmetry. In the case of proprietary technology, due to the difficulty associated with evaluating technology without adequately understanding it, an MNE will be more likely to choose in-house operations over other modes of operation such as licensing. Empirical evidence shows that R&D expenditure that generates proprietary technology is positively associated with both licensing practices and direct investment, but the effect is stronger for direct investments (Anderson & Gatignon, 1986). Once an MNE decides to choose in-house operations, it has the choice between WOSs and IJVs. Due to concerns over unwanted dissemination (Benito et al., 2009) and leakage of know-how to JV partners, it is likely that it will choose WOSs over IJVs. Empirical evidence shows that higher R&D expenditure is positively associated with WOSs rather than IJVs (Stopford & Wells, 1972).

Meanwhile, brands and trademarks represent revenue-generating assets in which an MNE has incurred a major investment. Due to the reputational nature of brands and trademarks, a widely publicized scandal by an outside partner may seriously harm the reputation of a well-established brand overnight. As a result, an MNE with brands and trademarks will prefer in-house operations over licensing in overseas expansion. When an MNE chooses in-house operations and has a choice between a WOS and an IJV, the opportunistic behavior of an IJV partner that might tarnish its brand image is a major concern for the MNE (Benito, 2015). As a result, a WOS would be the preferred choice over an IJV. Thus, we propose a positive association between market-seeking FDI and a preference for WOSs over IJVs.
Second, in the case of resource-seeking FDI, we differentiate between natural-resource-seeking and labor-seeking FDI. In natural-resource-seeking FDI, the main market failure is asset specificity for the focal MNE, which entails two major risks: hold-up risk and under-investment of transaction partners (Benito, 2015). For an MNE operating in extractive industries, its heavy investment upfront for specialized machinery and infrastructure will subject it to hold-up risks from contracting partners. As a result, it is likely to internalize the transaction. However, in reality, national governments often control local extractive resources and local partners are often chosen to deal with different stakeholders including governments, employees, and local residents (Gil et al., 2006; Yu et al., 2015). In places with institutional voids and instability, there is an even stronger need to find a local partner (Yu et al., 2015). Here, MNEs will prefer to internalize the transaction if it is involved in natural-resource-seeking behavior, so WOSs will be the preferred operation mode. However, in locations characterized by high institutional voids and instability, an IJV will be preferred over a WOS.

With regard to labor-seeking FDI, due to the abundance of cheap labor worldwide and the low switching costs from one labor supplier to another, there is less risk of market failure from hold-up behavior by the business partner. As a result, an MNE will prefer to have an open transaction with market partners and have multiple suppliers at the same time. Further, there is less necessity to internalize the operation, which explains the prevalence of global sourcing (Anderson & Gatignon, 1986). When an MNE chooses to establish a subsidiary in a host country, due to consideration of tariffs and local content requirements, an IJV will be chosen over a WOS, as an IJV partner can offer complementary resources (Beamish & Banks, 1987) and requires less resource commitment from the focal MNE.

Third, in terms of efficiency-seeking FDI, an MNE may be engaged in rationalizing its production network or distribution network. The major market failure is asset specificity. In the case of production networks, there are considerable transaction-specific assets involved in rationalizing production networks, such as logistics and IT infrastructure, and there is a strong need for vertical integration. Here, an MNE will prefer to internalize the transaction with a business partner. If an MNE chooses to establish a subsidiary, WOSs
will be chosen over IJVs. In the case of distribution networks, in addition to the need for vertical integration, there is also a potential risk of free-riding from business partners (Anderson & Gatignon, 1986). As a result, an MNE will prefer to internalize the transaction and a WOS will be preferred over an IJV when a subsidiary is established.

Fourth, in strategic-asset-seeking FDI, an MNE is interested in gaining full access and control of such assets as proprietary technology, management know-how, and distribution networks (Luo & Tung, 2007, 2018). The major market failure is information content mentioned above. Due to the strong need for control, it will opt for internalization, i.e., buy a target company instead of undertaking a market transaction. When an MNE acquires a firm for strategic-asset-seeking purposes, it is likely to choose WOSs over IJVs so that it can have full access and control over strategic assets.

Fifth, we consider support functions such as trade support (sales offices), financial support (financing and currency hedging), and management support (regional management centers). These functions are vital to the operations of the MNE and the major market failure involved is information content such as business secrets. To avoid the risk of opportunistic behavior by business partners and the unwanted dissemination of business secrets, an MNE will prefer to internalize the transaction instead of contracting a business partner. After a subsidiary is established, a high-control mode such as a WOS will likely be preferred over an IJV, due to the need to completely control the subsidiary.

Hence, we provide the following hypotheses:

**Hypothesis 3a:**

*Market-seeking FDI will prefer WOSs over IJVs;*
*Resource-seeking FDI will prefer IJVs over WOSs;*
*Efficiency-seeking FDI will prefer WOSs over IJVs;*
*Strategic-asset-seeking FDI will prefer WOSs over IJVs;*
*FDIs with support investment purposes will prefer WOSs over IJVs.*
2.2.4 Investment Motives and Expatriate Deployment

Expatriates play multiple roles in a subsidiary, i.e., as a strategist, monitor, ambassador, daily manager, and trainer (Peng & Meyer, 2016). The ambassador role is for stakeholder management purposes. The roles of strategist, monitor, and daily manager are for control purposes and the alignment of the goal of the MNE headquarters and the subsidiary. The role of trainer is for knowledge transfer (Delios & Bjorkman, 2000).

Drawing from the framework of vertical versus horizontal FDI (Slangen & Beugelsdijk, 2010), we first categorize investment motives into two categories. Market-seeking investments are horizontal FDI, while resource-seeking, efficiency-seeking, strategic-asset-seeking investments and support functions are vertical FDI. Because there is a stronger need for the alignment of interests between the MNE and subsidiaries for vertical FDI than for horizontal FDI (Paik & Ando, 2011) and local managers have better knowledge about the host country than expatriate managers, we propose that there is a higher expatriate deployment in vertical FDI than in horizontal FDI. Hence, we propose the following hypothesis:

**Hypothesis 3b:** Subsidiaries with horizontal investment motives have a lower expatriate ratio than those with vertical investment motives.

2.2.5 Investment Motives and Subsidiary Size

Existing major theories in management make an implicit assumption that firm size will grow. The resource-based view (Penrose, 1995) has argued that the firm will grow until management capabilities put a limit on the growth potential of the firm. Meanwhile, according to TCE (Coase, 1937), when the cost of internal coordination is greater than the cost of market transactions, the firm will stop growing. There is a limited number of studies in IB on subsidiary size, including those focused on firm size and control (Johnston & Menguc, 2007; Peng & Beamish, 2014) and firm size and divestment (Duhaime & Baird, 1987).

We draw upon contingency theory (Lawrence & Lorsch, 1967), especially the relationship between strategy and structure (Chandler, 1962), to establish the linkage
between investment motives and subsidiary size. As per contingency theory, the structure of an organization is contingent upon its external and internal needs. Chandler’s (1962) classic study of diversification strategy and divisionalization structure showed that changes in strategy required corresponding adjustments in organizational structure. Subsequent research confirmed his idea that structure followed strategy. For example, Rumelt (1974) showed that the match between strategy and structure has a significant impact on performance. Miller (1986, 1996) added that, given the organizational structure and business environment, there are limited strategies available to an organization. In international business, Birkinshaw and Morrison (1995) argued that the fit between the strategy and structure of a subsidiary influences its performance.

Investment motives can also be classified into major investment motives, i.e., resource seeking, market seeking, efficiency seeking, and strategic asset seeking, and those in support functions, such as sales support, management support, financial support, etc. Due to the differences in strategic goals, we argue that those with a support function will have a smaller subsidiary size than those with a major function. For example, a sales office can be staffed with a handful of employees yet be fully operational, given the nature of the business. A regional management office is usually smaller compared with an average-sized subsidiary, as it only performs one function—to implement tight control between the subsidiary and headquarters. However, the size of the subsidiary will be much larger if the main purpose is to access local cheap labor, to have access to local markets, or to have a team for research and development. Hence, we present the following hypothesis:

**Hypothesis 3c:** The size of subsidiaries with support investment motives will be smaller than that of subsidiaries with the major investment motives.

### 2.2.6 Investment Motives and Performance

As discussed earlier, organization performance is a multi-dimensional measure (Richard, et al., 2009). Different measures have been suggested for different types of investment (Benito, 2015). For example, in market-seeking FDI, relevant measures include sales growth and market share. For efficiency-seeking FDI, appropriate measures include profit margins. For natural-resource-seeking FDI, measures include input costs and the stability
of suppliers. For strategic-asset-seeking FDI, new patents for the MNE could be an appropriate measure. We limit our discussion to subsidiary-level performance, as measured by profitability and sales growth.

We draw upon the framework of vertical versus horizontal FDI (Slangen & Beugelsdijk, 2010) to establish a linkage between investment motives and subsidiary-level performance. First, in terms of the sales growth of a subsidiary, market-seeking FDI (i.e., horizontal FDI) is more likely to outperform other types of investments (vertical FDI including natural-resource-seeking, efficiency-seeking, and strategic-asset-seeking FDI), as the main objective of market-seeking FDI is revenue growth, while other investments are interested in lowering the cost for the MNE as a whole.

Second, in terms of the profitability of the subsidiary, it is contingent upon the timeframe used for gauging the performance (Verbeke et al., 2009). For natural-resource-seeking FDI, especially in extractive investments, there is a huge investment upfront and it takes a longer time to break even compared with a typical subsidiary such as a manufacturing facility. If the investment is for the purpose of accessing low-cost labor, then it is likely to be profitable due to its nature as a low-cost production base. For market-seeking FDI, investment with the purpose of building new business is likely to underperform versus other investments as far as profitability is concerned because of the risks involved. For efficiency-seeking FDI, investment is likely to be profitable due to economies of scale and scope. For strategic-asset-seeking FDI, especially that invested in R&D development, due to the risks involved in new R&D development, it is also unrealistic to expect quick profitability. Hence, we present the following hypothesis:

**Hypothesis 4:** FDIs with horizontal investment motives will perform better than those with vertical investment motives.

2.3 Data and Sample Selection

2.3.1 Data Source

The Kaigai Shinshutsu Kigyo Soran (Japanese Overseas Investment) dataset (Toyo Keizai, 2017) was used for subsidiary-level information. It was matched with Nikkei
NEEDS data for MNE parent-level information. This matched dataset was selected for three reasons. First, the TK dataset is the most comprehensive data source on Japanese foreign investment (Sachwald, 1995). Primary data were collected from the managers of overseas affiliates through the Japanese parent firms. Information from other sources such as press releases, annual reports, and telephone interviews was also included (Makino et al., 2004). Second, it is a longitudinal dataset spanning 27 years from 1991 to 2017, which allows for panel data analysis. Third, it has detailed information on the investment purposes of the parent firms of the subsidiaries, which is generally not available from sources where country (Brouthers, Gao, & McNicol, 2008) or industry (Nachum & Zaheer, 2005) aggregate-level data is used.

2.3.2 Sample Selection and the Decision Rules

The 16 categories of investment purposes from the Toyo Keizai dataset (TK dataset) were condensed into six types of investment motives defined by Dunning (1993), and Dunning and Lundan (2008): (1) natural resource seeking; (2) market seeking; (3) efficiency seeking; (4) strategic asset seeking; (5) support investment; and (6) passive investment (see Table 2). The logic behind these allocations is as follows.

First, natural resource seekers are defined as those “seeking physical resources of one kind or another” and those “seeking plentiful suppliers of cheap and well-motivated unskilled or semi-skilled labor” (Dunning & Lundan, 2008: 68). As a result, those in Categories A (natural resources, materials) and B (labor intensity) were put into the first type of investment motive: natural resource seeking.

Second, market seekers are defined as those “that invest in a particular country or region to supply goods or services to markets in these or adjacent countries” (Dunning & Lundan, 2008: 69). They are treated as “self-contained production units” (Dunning & Lundan, 2008: 71). Examples here include those that follow their customers, adopt their products to local needs, or are attracted by tax breaks from host countries. Following the definition and examples, those in Categories C (tax breaks for investment), F (local market access), I (alliances with customers in Japan), and M (building new business) were put into the second type of investment motive: market seeking.
Table 2: Classifications of investment purposes

<table>
<thead>
<tr>
<th>Investment motive</th>
<th>Definition offered by Dunning (1993)</th>
<th>TK Categories</th>
</tr>
</thead>
</table>
| 1. Natural resource seeking? | 1. Physical resources, such as minerals, agricultural products  
2. Cheap and motivated unskilled or semi-skilled labor | A = natural resources, materials  
B = labor intensity |
| 2. Market seeking | Definition: invest in a particular country or region to supply goods or services to markets in these or adjacent countries  
1. Follow customers  
2. Localization needs  
3. Import substituting  
4. Response to competitors’ moves  
5. Local government policy | C = tax breaks for investment  
F = local market access  
I = alliances with customers in Japan  
M = building new business |
| 3. Efficiency seeking | 1. To rationalize the structure of established resource-based or market-seeking investments  
2. Benefits include economies of scale, scope, and risk diversification | D = building an international network of production  
E = building an international network of distribution |
| 4. Strategic asset seeking | To sustain or advance their global competitiveness | L = research & development |
| 5. Escape investment | | |
| 6. Trade-supportive investment | | |
| 7. Finance-supportive investment | | J = financing, currency hedging |
| 8. Management-supportive investment | | K = information gathering, royalty revenue  
N = control business of the area |
| 9. Passive investment | 1. Portfolio institutional investment  
2. Real-estate investment | |

Although Dunning (1993) also proposed a third type of resource seeking, which is to “acquire technological capability, management or marketing expertise and organizational skills” (p. 57), it is not included in our table due to the overlap between this type of investment and strategic asset seeking (Cuervo-Cazurra & Narula, 2015).
Third, efficiency seeking is defined as “rationalizing the structure of established resource-based or market-seeking investment in such a way that the investing company can gain from the common governance of geographically dispersed activities. Such benefits are essentially those of the economies of scale and scope and of risk diversification” (Dunning & Lundan, 2008: 72). Following this definition, investment motives in Categories D (building an international network of production) and E (building an international network of distribution) were classified as efficiency seekers.

Fourth, strategic asset seekers are less interested in exploiting existing firm advantages, and more interested in augmenting their “global portfolio of physical assets and human competence” (Dunning & Lundan, 2008: 73). Investments in Category L (research and development) were classified as strategic asset seeking.

Fifth, support investment is defined as investments taken “to support the activities of the rest of the enterprise of which they are part” and they are “rarely self-contained profit centers” (Dunning & Lundan, 2008: 74). They include trading companies, financial support companies, and regional or branch offices. Regional offices sometimes provide “financial and marketing information for the parent company” (Dunning & Lundan, 2008: 75). Following the definition and examples given, Categories J (financing, currency hedging), K (information gathering, royalty revenue), and N (control businesses of the area) were classified as support investments.

Sixth, passive investment refers to portfolio investment. The present study follows the logic of Dhanaraj and Beamish (2004) and used equity ownership level less than 20% as the cut-off point for passive investment, i.e., the first Japanese parent firm’s equity level is greater than 0% and less than 20%.

Seventh, in Dunning’s (1993) typology, there is another type of investment, “escape investment,” which is defined as “to escape restrictive legislation or macro-organizational policies by home governments” (Dunning & Lundan, 2008: 74). Examples include “round-tripping” investment between China and Hong Kong, which is used to exploit the
preferential treatment given to foreign investment (including investment from Hong Kong) by the Chinese government. The essence of this type of investment is that investors have to leave the home country for a better outcome. The closet category in the TK dataset is Category O (trade conflict), where producers have to relocate their investment to a third country to avoid steep tariffs imposed on their goods due to trade conflicts between home and host countries. However, due to its small proportion in the TK dataset (Table 3)—2,887 subsidiary-year observations (1.49%), which only amount to around 300 subsidiaries (assuming about 10 years of data per subsidiary)—Category O was excluded from our analysis.

Also excluded from the analysis were Category G (exports to other countries), Category H (exports to Japan), and Category P (other purposes) due to difficulty in allocating them in a single discrete category. For example, Category G (exports to other countries) can be put into both natural resource seeking (Chakravarty et al., 2017) and market seeking (Getachew & Beamish, 2017). A Japanese parent can invest in a low-labor-cost country in order to save on costs while seeking market access in a third country. All excluded observations together represent 48,674 subsidiary-year observations (8.74% of the entire sample). Also, due to the fact that multiple investment purposes can be recorded for one subsidiary and that those in Categories G, H, P, and O are likely to be recorded as the second or third purposes for a particular subsidiary-year, it is very likely that they have been included in other categories in our analysis.8

Before conducting the analysis of the characteristics and performance of affiliates of six types of investment purposes, a preliminary analysis was made on the distribution of the six types of investment motives (Table 3). In the 1991–2017 version of the TK dataset, there are 557,179 subsidiary-year observations: 8,318 Japanese MNEs investing in 56,193 subsidiaries in 164 countries. For each of the 557,179 subsidiary-year

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8 For example, Category G was recorded as the first investment purpose for only 697 subsidiary-year observations; however, 18,129 subsidiary-year observations reported G as one of the investment purposes in the TK dataset. This means that Category G could have been recorded as the second, third, or even fourth investment purpose. A similar pattern can be found for Categories H (774 versus 17,539), O (278 versus 2,887), and P (5,568 versus 10,119).
observations, a Japanese parent firm can choose multiple answers from the list of investment purposes for one subsidiary (Chakravarty et al., 2017). Meanwhile, if a subsidiary has multiple Japanese parent firms, duplicate answers are counted once. For example, if two Japanese parents choose “market access” as the investment purpose, market access is recorded once. There is no rank order among the 16 investment purposes. In the TK dataset, 194,171 subsidiary-year observations (34.8% of the whole dataset) recorded at least one investment purpose and they recorded an average of two investment purposes. In sum, (1) natural resource seekers represent 45,834 subsidiary-year observations (23.60%); (2) market seekers represent 161,844 subsidiary-year observations (83.35%); (3) efficiency seekers represent 94,180 subsidiary-year observations (48.50%); (4) strategic asset seekers represent 14,244 subsidiary-year observations (7.34%); (5) support investment represents 61,695 subsidiary-year observations (31.77%); and (6) passive investment represents 17,528 subsidiary-year observations (9.03%).


10 The maximum number of investment purposes was eight, which was recorded for a Thailand subsidiary. They cover labor intensity (B), tax breaks for investment (C), building an international production network (D), local market access (F), exports to other countries (G), exports to Japan (H), alliances with customers (I), and building new business (M).

11 These percentages are for those investments that reported up to eight investment purposes. As one subsidiary can have more than one investment purpose, the sum of all percentages will be greater than one.
Table 3: Converting investment purposes in TK dataset into six investment motives defined by Dunning & Lundan (2008)

<table>
<thead>
<tr>
<th>No.</th>
<th>Investment motive</th>
<th>Categories in the TK dataset</th>
<th>Observations (1 investment purpose)</th>
<th>Observations (up to 8 investment purposes)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td>Subsidiary-year observations (%)</td>
<td>Subsidiary-year observations (%)</td>
</tr>
<tr>
<td>1</td>
<td>Natural resource seekers</td>
<td>A = natural resources, materials</td>
<td>2,365 3.37</td>
<td>11,372 5.86</td>
</tr>
<tr>
<td></td>
<td></td>
<td>B = labor intensity</td>
<td>1,654 2.36</td>
<td>34,462 17.75</td>
</tr>
<tr>
<td></td>
<td></td>
<td>subtotal</td>
<td>4,019 5.73</td>
<td>45,834 23.60</td>
</tr>
<tr>
<td>2</td>
<td>Market seekers</td>
<td>C = tax breaks for investment</td>
<td>1,127 1.61</td>
<td>12,796 6.59</td>
</tr>
<tr>
<td></td>
<td></td>
<td>F = local market access</td>
<td>33,885 48.32</td>
<td>129,233 66.56</td>
</tr>
<tr>
<td></td>
<td></td>
<td>I = alliance with customers in Japan</td>
<td>1,320 1.88</td>
<td>11,104 5.72</td>
</tr>
<tr>
<td></td>
<td></td>
<td>M = building new business</td>
<td>713 1.02</td>
<td>8,711 4.49</td>
</tr>
<tr>
<td></td>
<td></td>
<td>subtotal</td>
<td>37,045 52.82</td>
<td>161,844 83.35</td>
</tr>
<tr>
<td>3</td>
<td>Efficiency seekers</td>
<td>D = building international production network</td>
<td>10,524 15.01</td>
<td>58,868 30.32</td>
</tr>
<tr>
<td></td>
<td></td>
<td>E = building international distribution network</td>
<td>4,052 5.78</td>
<td>35,312 18.19</td>
</tr>
<tr>
<td></td>
<td></td>
<td>subtotal</td>
<td>14,576 20.78</td>
<td>94,180 48.50</td>
</tr>
<tr>
<td>4</td>
<td>Strategic asset seekers</td>
<td>L = research and development</td>
<td>1,516 2.16</td>
<td>14,244 7.34</td>
</tr>
<tr>
<td></td>
<td></td>
<td>subtotal</td>
<td>1,516 2.16</td>
<td>14,244 7.34</td>
</tr>
<tr>
<td>5</td>
<td>Support investment</td>
<td>J = financing, currency hedging</td>
<td>2,027 2.89</td>
<td>6,671 3.44</td>
</tr>
<tr>
<td></td>
<td></td>
<td>K = information gathering, royalty collection</td>
<td>2,569 3.66</td>
<td>47,517 24.47</td>
</tr>
<tr>
<td></td>
<td></td>
<td>N = control business of the area</td>
<td>1,773 2.53</td>
<td>7,507 3.87</td>
</tr>
<tr>
<td></td>
<td></td>
<td>subtotal</td>
<td>6,369 9.08</td>
<td>61,695 31.77</td>
</tr>
<tr>
<td>6</td>
<td>Passive investment</td>
<td>Equity share of first Japanese parent firm &lt;20%</td>
<td>3,046 4.34</td>
<td>17,528 9.03</td>
</tr>
<tr>
<td></td>
<td></td>
<td>subtotal</td>
<td>3,046 4.34</td>
<td>17,528 9.03</td>
</tr>
<tr>
<td>7</td>
<td>Other</td>
<td>G = exports to other countries</td>
<td>275 0.39</td>
<td>18,129 9.34</td>
</tr>
<tr>
<td></td>
<td></td>
<td>H = exports to Japan</td>
<td>509 0.73</td>
<td>17,539 9.03</td>
</tr>
<tr>
<td></td>
<td></td>
<td>O = trade conflict</td>
<td>253 0.36</td>
<td>2,887 1.49</td>
</tr>
<tr>
<td></td>
<td></td>
<td>P = other purposes</td>
<td>5,568 7.94</td>
<td>10,119 5.21</td>
</tr>
<tr>
<td></td>
<td></td>
<td>subtotal</td>
<td>6,605 9.42</td>
<td>48,674 25.07</td>
</tr>
<tr>
<td>8</td>
<td>total</td>
<td></td>
<td>70,130 10.42</td>
<td>194,171</td>
</tr>
</tbody>
</table>
2.3.3 Main Statistical Tools

In the exploratory analysis, frequency distributions have been run for the general distribution of investment purposes and regression tests (OLS linear regression and binary logistic regression) have been run to test the relationship between investment purposes and subsidiary-level characteristics and performance.

2.4 Preliminary Analysis Results

The frequency distribution of the number of investment purposes is shown in Table 4. Among those that reported investment purposes, 70,130 subsidiary-year observations reported one investment purpose (36.12%), 57,330 reported two investment purposes (29.53%), and 37,098 reported three investment purposes (19.11%).

Table 4: Frequency distribution of subsidiary-year observations by number of investment purposes

<table>
<thead>
<tr>
<th>Number of investment purposes</th>
<th>Frequency</th>
<th>Percentage (%)</th>
<th>Cumulative percentage (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>70,130</td>
<td>36.12</td>
<td>36.12</td>
</tr>
<tr>
<td>2</td>
<td>57,330</td>
<td>29.53</td>
<td>65.64</td>
</tr>
<tr>
<td>3</td>
<td>37,098</td>
<td>19.11</td>
<td>84.75</td>
</tr>
<tr>
<td>4</td>
<td>17,953</td>
<td>9.25</td>
<td>93.99</td>
</tr>
<tr>
<td>5</td>
<td>11,410</td>
<td>5.88</td>
<td>99.87</td>
</tr>
<tr>
<td>6</td>
<td>226</td>
<td>0.12</td>
<td>99.99</td>
</tr>
<tr>
<td>7</td>
<td>23</td>
<td>0.01</td>
<td>100</td>
</tr>
<tr>
<td>8</td>
<td>1</td>
<td>0</td>
<td>100</td>
</tr>
<tr>
<td>Total</td>
<td>194,171</td>
<td>100</td>
<td>100</td>
</tr>
</tbody>
</table>

2.4.1 Descriptive Data on Investment Purposes

2.4.1.1 Frequency Distributions

Of the 70,130 subsidiary-year observations that reported one investment purpose (Table 5), the top category is F (local market access, 48.32%), followed by D (building an international production network, 15.01%).
Table 5: Frequency distribution of subsidiary-year observations with one investment purpose

<table>
<thead>
<tr>
<th>No.</th>
<th>Investment purpose</th>
<th>Frequency</th>
<th>(%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>F = local market access</td>
<td>33,885</td>
<td>48.32</td>
</tr>
<tr>
<td>2</td>
<td>D = building an international production network</td>
<td>10,524</td>
<td>15.01</td>
</tr>
<tr>
<td>3</td>
<td>P = other purposes</td>
<td>5,568</td>
<td>7.94</td>
</tr>
<tr>
<td>4</td>
<td>E = building an international distribution network</td>
<td>4,052</td>
<td>5.78</td>
</tr>
<tr>
<td>5</td>
<td>K = information gathering and royalty revenue</td>
<td>2,569</td>
<td>3.66</td>
</tr>
<tr>
<td>6</td>
<td>A = natural resources and materials</td>
<td>2,365</td>
<td>3.37</td>
</tr>
<tr>
<td>7</td>
<td>J = financing and currency hedging</td>
<td>2,027</td>
<td>2.89</td>
</tr>
<tr>
<td>8</td>
<td>N = control business of the area</td>
<td>1,773</td>
<td>2.53</td>
</tr>
<tr>
<td>9</td>
<td>B = labor intensity</td>
<td>1,654</td>
<td>2.36</td>
</tr>
<tr>
<td>10</td>
<td>L = research and development</td>
<td>1,516</td>
<td>2.16</td>
</tr>
<tr>
<td>11</td>
<td>I = alliances with customers in Japan</td>
<td>1,320</td>
<td>1.88</td>
</tr>
<tr>
<td>12</td>
<td>C = tax breaks for investment</td>
<td>1,127</td>
<td>1.61</td>
</tr>
<tr>
<td>13</td>
<td>M = building new business</td>
<td>713</td>
<td>1.02</td>
</tr>
<tr>
<td>14</td>
<td>H = exports to Japan</td>
<td>509</td>
<td>0.73</td>
</tr>
<tr>
<td>15</td>
<td>G = exports to other countries</td>
<td>275</td>
<td>0.39</td>
</tr>
<tr>
<td>16</td>
<td>O = trade conflict</td>
<td>253</td>
<td>0.36</td>
</tr>
<tr>
<td></td>
<td>Total</td>
<td>70,130</td>
<td>100</td>
</tr>
</tbody>
</table>

Among those 57,330 subsidiary-year observations that reported two investment purposes, nine combinations have over 1,000 subsidiary-year observations (Table 6). A closer examination shows that eight out of nine categories have F (local market access) as one element. The top category is FK (local market access; information gathering, royalty revenue), with 12,839 subsidiary-year observations, followed by FD (local market access; building international production network), with 9,432 subsidiary-year observations, and FE (local market access; building international distribution network), with 6,439 subsidiary-year observations.
Table 6: Frequency distribution of subsidiary-year observations with two investment purposes (top nine categories)

<table>
<thead>
<tr>
<th>No.</th>
<th>Items</th>
<th>Frequency</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>FK = “local market access” and “information gathering and royalty revenue”</td>
<td>12,839</td>
</tr>
<tr>
<td>2</td>
<td>DF = “building an international production network” and “local market access”</td>
<td>9,432</td>
</tr>
<tr>
<td>3</td>
<td>EF = “building an international distribution network” and “local market access”</td>
<td>6,439</td>
</tr>
<tr>
<td>4</td>
<td>BF = “labor intensity” and “local market access”</td>
<td>3,315</td>
</tr>
<tr>
<td>5</td>
<td>BD = “labor intensity” and “building an international production network”</td>
<td>2,192</td>
</tr>
<tr>
<td>6</td>
<td>CF = “tax breaks for investment” and “local market access”</td>
<td>1,705</td>
</tr>
<tr>
<td>7</td>
<td>FG = “local market access” and “exports to other countries”</td>
<td>1,466</td>
</tr>
<tr>
<td>8</td>
<td>FI = “local market access” and “alliances with customers in Japan”</td>
<td>1,267</td>
</tr>
<tr>
<td>9</td>
<td>FP = “local market access” and “other purposes”</td>
<td>1,043</td>
</tr>
</tbody>
</table>

A similar pattern can be found for those 37,098 subsidiary-year observations that reported three investment purposes (Table 7). Nine combinations have over 1,000 subsidiary-year observations. Eight out of nine categories have F (local market access) as an element. The top category is FKE (local market access; information gathering, royalty revenue; building an international distribution network), with 3,735 subsidiary-year observations, followed by FDB (local market access; building international production network; labor intensity), with 3,087 subsidiary-year observations, and FED (local market access; building international distribution network; building international production network), with 2,127 subsidiary-year observations.

2.4.1.2 Annual Growth Patterns

This section provides an analysis on the annual growth pattern of investments of different purposes for two types of data: (1) subsidiary-year observations that reported only one investment purpose.

---

12 We have also run the frequency distributions of those that reported four or five investment purposes. There are 16 * 15 * 14 * 13 = 43,680 possible combinations of four investment purposes and 16 * 15 * 14 * 13 * 12 = 524,160 possible combinations of five investment purposes. Most of these combinations have zero observations and the top category has no more than 100 subsidiary-year observations. A detailed report is available upon request.
investment purpose (i.e., 70,130 subsidiary-year observations); (2) subsidiary-year observations that reported up to eight investment purposes (i.e., 194,171 subsidiary-year observations). For example, one observation could have reported an investment purpose of A (natural resources, materials) but it could also have reported other investment purposes such as B (labor intensity) or C (tax breaks for investment).

Table 7: Frequency distribution of subsidiary-year observations with three investment purposes (top nine categories)

<table>
<thead>
<tr>
<th>No.</th>
<th>Items</th>
<th>Frequency</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>EFK = “building an international distribution network,” “local market access,” and “information gathering and royalty revenue”</td>
<td>3,735</td>
</tr>
<tr>
<td>2</td>
<td>BDF = “labor intensity,” “building an international production network,” and “local market access”</td>
<td>3,087</td>
</tr>
<tr>
<td>3</td>
<td>DEF = “building an international production network,” “building an international distribution network,” and “local market access”</td>
<td>2,127</td>
</tr>
<tr>
<td>4</td>
<td>DFG = “building an international production network,” “local market access,” and “exports to other countries”</td>
<td>1,322</td>
</tr>
<tr>
<td>5</td>
<td>BCF = “labor intensity,” “tax breaks for investment,” and “local market access”</td>
<td>1,200</td>
</tr>
<tr>
<td>6</td>
<td>DFK = “building an international production network,” “local market access,” and “information gathering and royalty revenue”</td>
<td>1,093</td>
</tr>
<tr>
<td>7</td>
<td>BFK = “labor intensity,” “local market access,” and “information gathering and royalty revenue”</td>
<td>1,056</td>
</tr>
<tr>
<td>8</td>
<td>BDH = “labor intensity,” “building an international production network,” and “exports to Japan”</td>
<td>1,048</td>
</tr>
<tr>
<td>9</td>
<td>FKL = “local market access,” “information gathering and royalty revenue,” and “research and development”</td>
<td>1,048</td>
</tr>
</tbody>
</table>

First, for those observations that reported only one investment purpose (70,130 subsidiary-year observations), the annual growth pattern is shown in Figures 1a to 16a. A closer examination shows that three investment purposes show an upward trend between 1991 and 2017: building an international production network (Figure 4a), building an international distribution network (Figure 5a), and controlling the business of the area (Figure 14a). Another three investment purposes show a clear downward trend: local market access (Figure 6a), information gathering and royalty collection (Figure 11a), and trade conflicts (Figure 15a). There is no clear pattern for other investment purposes.

Meanwhile, subgroups within a category show different growth patterns. For example,
within the big category of market access, “alliances with customers in Japan” shows a general upward trend, while “local market access” shows a downward trend, and the trend for other subcategories is less clear.
Figure 1a & 1b: Percentage of subsidiary-year observations with investment purpose: “natural resources and materials” over all subsidiary-year observations with one investment purpose in each year

Figure 2a & 2b: Percentage of subsidiary-year observations with investment purpose: “labor intensity” over all subsidiary-year observations with one investment purpose in each year
Figure 3a & 3b: Percentage of subsidiary-year observations with investment purpose: “tax breaks for investment” over all subsidiary-year observations with one investment purpose in each year

Figure 4a & 4b: Percentage of subsidiary-year observations with investment purpose: “building an international production network” over all subsidiary-year observations with one investment purpose in each year
Figure 5a & 5b: Percentage of subsidiary-year observations with investment purpose: “building an international distribution network” over all subsidiary-year observations with one investment purpose in each year

Figure 6a & 6b: Percentage of subsidiary-year observations with investment purpose: “local market access” over all subsidiary-year observations with one investment purpose in each year
Figure 7a & 7b: Percentage of subsidiary-year observations with investment purpose: “exports to other countries” over all subsidiary-year observations with one investment purpose in each year

Figure 8a & 8b: Percentage of subsidiary-year observations with investment purpose: “exports to Japan” over all subsidiary-year observations with one investment purpose in each year
Figure 9a & 9b: Percentage of subsidiary-year observations with investment purpose: “alliances with customers in Japan” over all subsidiary-year observations with one investment purpose in each year

Figure 10a & 10b: Percentage of subsidiary-year observations with investment purpose: “financing and currency hedging” over all subsidiary-year observations with one investment purpose in each year
Figure 11a & 11b: Percentage of subsidiary-year observations with investment purpose: “information gathering and royalty revenue” over all subsidiary-year observations with one investment purpose in each year

Figure 12a & 12b: Percentage of subsidiary-year observations with investment purpose: “research and development” over all subsidiary-year observations with one investment purpose in each year
Figure 13a & 13b: Percentage of subsidiary-year observations with investment purpose: “building new business” over all subsidiary-year observations with one investment purpose in each year

Figure 14a & 14b: Percentage of subsidiary-year observations with investment purpose: “control business of the area” over all subsidiary-year observations with one investment purpose in each year
Figure 15a & 15b: Percentage of subsidiary-year observations with investment purpose: “trade conflict” over all subsidiary-year observations with one investment purpose in each year

Figure 16a & 16b: Percentage of subsidiary-year observations with investment purpose: “other purposes” over all subsidiary-year observations with one investment purpose in each year
Second, when those observations that reported up to eight investment purposes are examined (Figures 1b to 16b), the general pattern is similar to those with only one investment purpose, but the percentages are higher in all categories because one subsidiary-year observation can be counted in different categories.

2.4.2 Characteristics and Performance

Next, a comparison is presented of the characteristics and performance among investment according to the different types of investment purposes.

2.4.2.1 Descriptive Statistics

Table 8: Descriptive statistics for selected variables at affiliate level\textsuperscript{13}

<table>
<thead>
<tr>
<th>Variable</th>
<th>Subsidiary-year observations</th>
<th>Mean</th>
<th>Median</th>
<th>Std. Dev.</th>
<th>Min.</th>
<th>Max</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue (’000 USD)</td>
<td>38,218</td>
<td>63,466</td>
<td>7.695</td>
<td>811,127</td>
<td>0</td>
<td>106,000,000</td>
</tr>
<tr>
<td>Number of employees</td>
<td>62,643</td>
<td>187</td>
<td>30</td>
<td>881</td>
<td>0</td>
<td>79,003</td>
</tr>
<tr>
<td>Revenue per employee (’000 USD)</td>
<td>34,667</td>
<td>1,460</td>
<td>189.14</td>
<td>19,199</td>
<td>0</td>
<td>1,507,406</td>
</tr>
<tr>
<td>Number of expats</td>
<td>59,459</td>
<td>3</td>
<td>2</td>
<td>6</td>
<td>0</td>
<td>338\textsuperscript{14}</td>
</tr>
<tr>
<td>Ratio of expats to total employees</td>
<td>53,831</td>
<td>0.10</td>
<td>0.04</td>
<td>0.14</td>
<td>0.00</td>
<td>1.00</td>
</tr>
<tr>
<td>First Japanese parent’s ownership level (%)</td>
<td>70,078</td>
<td>69.76</td>
<td>90</td>
<td>35.14</td>
<td>0.00</td>
<td>100.00</td>
</tr>
<tr>
<td>Subjective performance (3 = gain, 2 = breakeven, 1 = loss)</td>
<td>26,572</td>
<td>2.42</td>
<td>3</td>
<td>0.77</td>
<td>1.00</td>
<td>3.00</td>
</tr>
</tbody>
</table>

\textsuperscript{13} Because all the variables have highly skewed distributions, the median is also included for descriptive purposes.

\textsuperscript{14} The subsidiary is Canon USA. It had 4,980 local employees in 1991, with 338 expats.
Descriptive statistics were calculated for affiliate-level characteristics (revenue, employee, revenue per employee, number of expats, ratio of expats to local employees, the first Japanese parent’s ownership level) and performance, which is measured by a subjective evaluation of subsidiary profitability by the MNE headquarters. Performance has three categories: gain, breakeven, and loss.

The descriptive statistics for a few selected variables of interest at the affiliate level are shown in Table 8, which covers revenue, number of employees, revenue per employee, number of expatriates, ratio of expatriates to local employees, the first Japanese parent’s ownership level, and a subjective measure of performance (i.e., 3 = gain, 2 = breakeven, 1 = loss). It shows that the median revenue is US$7.69 million and the median number of local employees is 30. The median revenue per employee is US$189,000. The average number of expatriates is three and the ratio of expatriates to local employees is 0.14. The average ownership level of the first Japanese parent is 70%. In terms of performance, most affiliate managers rate their performance as half-way between gain and breakeven. These variables show different levels of missing values, with the ownership level having the least missing data and the subjective performance having the most missing data.

2.4.2.2 Differences in Characteristics and Performance

Table 9 indicates that affiliates with various investment purposes differ significantly across the five dimensions of revenue, number of employees, revenue per employee, number of expats, and ratio of expats to local employees. First, the highest three categories in terms of revenue are O (trade conflict, US$345.7 million), G (exports to other countries, US$162.2 million), and A (natural resources and materials, US$132.8 million), and the lowest three categories are M (building new business, US$10.1 million), H (exports to Japan, US$14.8 million), and B (labor intensity, US$18.3 million). One possible explanation for the above result is that exports to other countries are used for market seeking (or revenue-generating purposes), while affiliates engaged in natural resources and materials are usually mining companies, which can generate a huge amount of revenue. Those with the lowest revenue may be part of the vertical value chain of the parent MNEs, such as “exports to Japan” and “labor intensity,” where transfer pricing is
## Table 9: Affiliate-level characteristics

| No. | Investment motive | Category in TK dataset | Revenue ('000 USD) | No. of employees | Revenue per employee ('000 USD) | No. of expats | Expats Ratio | Coefficient of OLS regression
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Natural resource seekers</td>
<td>A = natural resources, materials</td>
<td>132,810</td>
<td>182</td>
<td>2,525</td>
<td>2.88</td>
<td>0.13</td>
<td>0.03***</td>
</tr>
<tr>
<td></td>
<td></td>
<td>B = labor intensity</td>
<td>18,381</td>
<td>281</td>
<td>145</td>
<td>3.20</td>
<td>0.04</td>
<td>-0.07***</td>
</tr>
<tr>
<td>2</td>
<td>Market seekers</td>
<td>C = tax breaks for investment</td>
<td>28,293</td>
<td>281</td>
<td>415</td>
<td>2.70</td>
<td>0.07</td>
<td>-0.03***</td>
</tr>
<tr>
<td></td>
<td></td>
<td>F = local market access</td>
<td>59,190</td>
<td>151</td>
<td>1,335</td>
<td>3.18</td>
<td>0.09</td>
<td>-0.01***</td>
</tr>
<tr>
<td></td>
<td></td>
<td>I = alliances with customers in Japan</td>
<td>26,230</td>
<td>151</td>
<td>625</td>
<td>2.85</td>
<td>0.10</td>
<td>-0.002</td>
</tr>
<tr>
<td></td>
<td></td>
<td>M = building new business</td>
<td>10,150</td>
<td>242</td>
<td>610</td>
<td>1.66</td>
<td>0.12</td>
<td>0.02**</td>
</tr>
<tr>
<td>3</td>
<td>Efficiency seekers</td>
<td>D = building an international production network</td>
<td>77,385</td>
<td>408</td>
<td>308</td>
<td>4.06</td>
<td>0.03</td>
<td>-0.08***</td>
</tr>
<tr>
<td></td>
<td></td>
<td>E = building an international distribution network</td>
<td>69,121</td>
<td>76</td>
<td>2,072</td>
<td>2.21</td>
<td>0.11</td>
<td>0.01***</td>
</tr>
<tr>
<td>4</td>
<td>Strategic asset seekers</td>
<td>L = research and development</td>
<td>22,874</td>
<td>81</td>
<td>2,165</td>
<td>2.38</td>
<td>0.15</td>
<td>0.05***</td>
</tr>
<tr>
<td>5</td>
<td>Support investment</td>
<td>J = financing, currency hedging</td>
<td>62,146</td>
<td>15</td>
<td>10,663</td>
<td>1.12</td>
<td>0.31</td>
<td>0.21***</td>
</tr>
<tr>
<td></td>
<td></td>
<td>K = information gathering, royalty collection</td>
<td>64,225</td>
<td>107</td>
<td>746</td>
<td>2.66</td>
<td>0.21</td>
<td>0.11***</td>
</tr>
<tr>
<td></td>
<td></td>
<td>N = control business of the area</td>
<td>90,996</td>
<td>84</td>
<td>14,419</td>
<td>3.06</td>
<td>0.28</td>
<td>0.18***</td>
</tr>
<tr>
<td>6</td>
<td>Passive investment</td>
<td>Equity share of the first Japanese parent firm &lt; 20%</td>
<td>174,339</td>
<td>477</td>
<td>559</td>
<td>1.33</td>
<td>0.03</td>
<td></td>
</tr>
<tr>
<td>7</td>
<td>Other</td>
<td>G = exports to other countries</td>
<td>162,221</td>
<td>84</td>
<td>5,689</td>
<td>3.56</td>
<td>0.20</td>
<td>0.09***</td>
</tr>
<tr>
<td></td>
<td></td>
<td>H = exports to Japan</td>
<td>14,853</td>
<td>168</td>
<td>1,593</td>
<td>1.67</td>
<td>0.07</td>
<td>-0.04***</td>
</tr>
<tr>
<td></td>
<td></td>
<td>O = trade conflict</td>
<td>345,761</td>
<td>686</td>
<td>326</td>
<td>11.71</td>
<td>0.09</td>
<td>-0.02</td>
</tr>
<tr>
<td></td>
<td></td>
<td>F = other purposes</td>
<td>54,818</td>
<td>172</td>
<td>1,348</td>
<td>3.07</td>
<td>0.18</td>
<td>0.05***</td>
</tr>
<tr>
<td>8</td>
<td>Sample average</td>
<td>63,634</td>
<td>187</td>
<td>1,460</td>
<td>3.00</td>
<td>0.10</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

15 Results are based on the bivariate OLS regression of the ratio of expats to total employees on investment purposes, sample size = 53,832.
quite likely. As there is a risk associated with building new business (Category M), the lowest revenue is found in that category.

Second, regarding the number of employees, the highest three categories are O (trade conflict, 686), D (building an international production network, 408), and B (labor intensity, 281). The lowest three categories are J (financing, currency hedging, 15), E (building an international distribution network, 76), and L (research and development, 81). N (control business of the area, 84) and G (exports to other countries, 84) are also at the low end in terms of the number of employees. Apparently, those with production functions have a higher number of employees, while those in finance, sales, R&D, and regional management centers have fewer staff.

Third, in terms of revenue per employee, the top three categories are N (control business of the area), J (financing, currency hedging), and G (exports to other countries), which benefit from their small employee sizes. Meanwhile, those with more employees have the lowest rates of revenue per employee, such as O (trade conflict), D (building an international production network), and B (labor intensity).

Fourth, expatriate staffing is measured by the number of expats and its ratio to total employees (Peng & Beamish, 2014). The top three categories for the number of expats are O (trade conflict, 12), D (building an international production network, 4), and G (exports to other countries, 3.5). The lowest three categories for the number of expats are J (financing and currency hedging, 1.12), M (building new business, 1.66), and H (exports to Japan, 1.67). When the expats to total employee ratio is considered, the top three categories are J (financing and currency hedging, 0.31), N (control business of the area, 0.28), and K (information gathering, royalty revenue, 0.21). The lowest three categories are D (building an international production network, 0.03), B (labor intensity, 0.04), and H (exports to Japan, 0.07).

Table 10 shows the ownership modes by affiliates of different investment purposes. The general pattern is that WOS has the highest percentage, followed by minority, majority, and then even equity share. In terms of the percentage of WOS among various
investments, the top three categories are N (control business of the area, 92.6%), J (financing and currency hedging, 87.2%), and G (exports to other countries, 77.5%), while the lowest three categories are H (exports to Japan, 41.3%), A (natural resources and materials, 42.8%), and C (tax breaks for investment, 48.3%). Here, vertical and horizontal investment cannot explain the result, because categories N, H, and A are all vertical investments, but they have strikingly different WOS percentages.

The result in Table 11 shows the subjective performance evaluation by affiliate managers. Among those that have reported gains, the top three categories are B (labor intensity, 64%), J (financing and currency hedging, 63.2%), and F (local market access, 62.6%), while the lowest three categories are M (building new business, 35.4%), H (exports to Japan, 40.4%), and N (control business of the area, 35.4%). Although both B (labor intensity) and H (exports to Japan) are vertical investments, they have very different levels of “gain” outcome—64% versus 40%. Meanwhile, those categories with greater risks involved in the business such as M (building new business) and N (control business of the area) have a lower percentage of “gain.”

In sum, the data show quite a nuanced picture of investment according to different purposes. Neither the horizontal versus vertical investment framework (Slangen & Beugelsdijk, 2010) nor the main investment categories proposed by Dunning (1993) can explain them all. Thus, further extension is warranted.
### Table 10: Ownership modes (%)

<table>
<thead>
<tr>
<th>No.</th>
<th>Investment motive</th>
<th>Category in TK dataset</th>
<th>WOS</th>
<th>Majority</th>
<th>Even</th>
<th>Minority</th>
<th>Coefficient for logistic regression</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Natural resource seekers</td>
<td>A = natural resources, materials</td>
<td>42.8</td>
<td>16.1</td>
<td>6.5</td>
<td>34.6</td>
<td>−0.80***</td>
</tr>
<tr>
<td></td>
<td></td>
<td>B = labor intensity</td>
<td>52.1</td>
<td>15.1</td>
<td>7.6</td>
<td>25.2</td>
<td>−0.40***</td>
</tr>
<tr>
<td>2</td>
<td>Market seekers</td>
<td>C = tax breaks for investment</td>
<td>48.3</td>
<td>11.9</td>
<td>6.1</td>
<td>33.7</td>
<td>−0.56***</td>
</tr>
<tr>
<td></td>
<td></td>
<td>F = local market access</td>
<td>62.7</td>
<td>12.3</td>
<td>5.1</td>
<td>19.9</td>
<td>0.07***</td>
</tr>
<tr>
<td></td>
<td></td>
<td>I = alliances with customers in Japan</td>
<td>50.3</td>
<td>16.6</td>
<td>4.8</td>
<td>28.4</td>
<td>−0.48***</td>
</tr>
<tr>
<td></td>
<td></td>
<td>M = building new business</td>
<td>57.8</td>
<td>9.5</td>
<td>3.7</td>
<td>29</td>
<td>−0.16***</td>
</tr>
<tr>
<td>3</td>
<td>Efficiency seekers</td>
<td>D = building an international production network</td>
<td>51.3</td>
<td>20</td>
<td>6.6</td>
<td>22</td>
<td>−0.51***</td>
</tr>
<tr>
<td></td>
<td></td>
<td>E = building an international distribution network</td>
<td>65.1</td>
<td>12.9</td>
<td>4.3</td>
<td>17.7</td>
<td>0.14***</td>
</tr>
<tr>
<td>4</td>
<td>Strategic asset seekers</td>
<td>L = research and development</td>
<td>71.9</td>
<td>12.5</td>
<td>5</td>
<td>10.6</td>
<td>0.46***</td>
</tr>
<tr>
<td>5</td>
<td>Support investment</td>
<td>J = financing, currency hedging</td>
<td>87.2</td>
<td>4.7</td>
<td>2.3</td>
<td>5.8</td>
<td>1.46***</td>
</tr>
<tr>
<td></td>
<td></td>
<td>K = information gathering, royalty collection</td>
<td>71.7</td>
<td>8.5</td>
<td>5.8</td>
<td>14</td>
<td>0.45***</td>
</tr>
<tr>
<td></td>
<td></td>
<td>N = control business of the area</td>
<td>92.6</td>
<td>1.9</td>
<td>2</td>
<td>3.5</td>
<td>2.07***</td>
</tr>
<tr>
<td>6</td>
<td>other</td>
<td>G = exports to other countries</td>
<td>77.5</td>
<td>7.2</td>
<td>4.4</td>
<td>10.8</td>
<td>0.75***</td>
</tr>
<tr>
<td></td>
<td></td>
<td>H = exports to Japan</td>
<td>41.3</td>
<td>23.7</td>
<td>2.8</td>
<td>32.3</td>
<td>−0.84***</td>
</tr>
<tr>
<td></td>
<td></td>
<td>O = trade conflict</td>
<td>58.3</td>
<td>22.4</td>
<td>6.6</td>
<td>12.7</td>
<td>−0.14</td>
</tr>
<tr>
<td></td>
<td></td>
<td>P = other purposes</td>
<td>65.2</td>
<td>8.4</td>
<td>6.1</td>
<td>20.3</td>
<td>0.15***</td>
</tr>
<tr>
<td>7</td>
<td>Sample average</td>
<td></td>
<td>61.9</td>
<td>12.9</td>
<td>5.3</td>
<td>19.9</td>
<td></td>
</tr>
</tbody>
</table>

16 The co-efficients are drawn from the results of bivariate logistic regression of ownership modes (1 = WOS and 0= otherwise) on investment purposes (sample: those reported only one investment purpose; size: 61,613 subsidiary-year observations).
Table 11: Affiliate-level performance (%)

<table>
<thead>
<tr>
<th>No.</th>
<th>Investment motive</th>
<th>Category in TK dataset</th>
<th>Gain</th>
<th>Breakeven</th>
<th>Loss</th>
<th>Coefficients(^{17}) of logistic regression (gain = 1; breakeven or loss = 0)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Natural resource seekers</td>
<td>A = natural resources, materials</td>
<td>61.0</td>
<td>20.4</td>
<td>18.6</td>
<td>0.08</td>
</tr>
<tr>
<td></td>
<td></td>
<td>B = labor intensity</td>
<td>64.0</td>
<td>24.3</td>
<td>11.7</td>
<td>0.21*</td>
</tr>
<tr>
<td>2</td>
<td>Market seekers</td>
<td>C = tax breaks for investment</td>
<td>54.0</td>
<td>31.5</td>
<td>14.5</td>
<td>−0.22*</td>
</tr>
<tr>
<td></td>
<td></td>
<td>F = local market access</td>
<td>62.6</td>
<td>21.1</td>
<td>16.3</td>
<td>0.28***</td>
</tr>
<tr>
<td></td>
<td></td>
<td>I = alliance with customers in Japan</td>
<td>57.1</td>
<td>18.3</td>
<td>24.6</td>
<td>−0.09</td>
</tr>
<tr>
<td></td>
<td></td>
<td>M = building new business</td>
<td>35.4</td>
<td>27.0</td>
<td>37.6</td>
<td>−0.99***</td>
</tr>
<tr>
<td>3</td>
<td>Efficiency seekers</td>
<td>D = building an international production network</td>
<td>61.2</td>
<td>19.6</td>
<td>19.2</td>
<td>0.09*</td>
</tr>
<tr>
<td></td>
<td></td>
<td>E = building an international distribution network</td>
<td>61.3</td>
<td>24.6</td>
<td>14.1</td>
<td>0.09</td>
</tr>
<tr>
<td>4</td>
<td>Strategic asset seekers</td>
<td>L = research and development</td>
<td>43.7</td>
<td>25.2</td>
<td>31.2</td>
<td>−0.64***</td>
</tr>
<tr>
<td>5</td>
<td>Support investment</td>
<td>J = financing, currency hedging</td>
<td>63.1</td>
<td>25.3</td>
<td>11.6</td>
<td>0.17*</td>
</tr>
<tr>
<td></td>
<td></td>
<td>K = information gathering, royalty collection</td>
<td>49.3</td>
<td>33.9</td>
<td>16.8</td>
<td>−0.42***</td>
</tr>
<tr>
<td></td>
<td></td>
<td>N = control business of the area</td>
<td>40.9</td>
<td>34.0</td>
<td>25.2</td>
<td>−0.76***</td>
</tr>
<tr>
<td>6</td>
<td>Passive investment</td>
<td>Equity share of the first Japanese parent firm &lt; 20%</td>
<td>67.0</td>
<td>17.8</td>
<td>15.2</td>
<td></td>
</tr>
<tr>
<td>7</td>
<td>Other</td>
<td>G = exports to other countries</td>
<td>45.1</td>
<td>44.3</td>
<td>10.6</td>
<td>−0.57**</td>
</tr>
<tr>
<td></td>
<td></td>
<td>H = exports to Japan</td>
<td>40.4</td>
<td>43.6</td>
<td>16.0</td>
<td>−0.77***</td>
</tr>
<tr>
<td></td>
<td></td>
<td>O = trade conflict</td>
<td>55.3</td>
<td>14.6</td>
<td>30.1</td>
<td>−0.16</td>
</tr>
<tr>
<td></td>
<td></td>
<td>P = other purposes</td>
<td>51.9</td>
<td>28.4</td>
<td>19.6</td>
<td>−0.32***</td>
</tr>
<tr>
<td>8</td>
<td>Sample average</td>
<td></td>
<td>59.2</td>
<td>23.2</td>
<td>17.6</td>
<td></td>
</tr>
</tbody>
</table>

\(^{17}\) The result is based upon bivariate logistic regression of performance on investment purposes; sample size = 26,572.
2.5 Preliminary Discussion

This chapter reintroduced the centrality of investment purposes to IB research (Dunning & Lundan, 2008) and proposed a theoretical framework with antecedents and consequences for different investment motives. It integrates theoretical arguments on the joint efforts of ownership advantages and home- and host-country location advantages on investment motives (Cuervo-Cazurra & Narula, 2015; Narula, 2012; Meyer et al., 2011) and the systematic differences in affiliate-level characteristics (such as size, mode choice, and expatriate deployment) and performance associated with each type of investment motive (Benito, 2015). We tested our hypotheses using the TK dataset. The preliminary results largely supported Hypotheses 3 and 4. The details are as follows.

2.5.1 Size

The size of the affiliates is measured by the number of local employees. The sample average is 187, while those in manufacturing functions such as those with the purposes of “labor intensity” (281), “tax breaks for investment” (281), and “building an international production network” (408) consistently have a higher-than-average number of employees. Meanwhile, those with a finance (“financing and currency hedging”: 15), sales (“building an international distribution network”: 76), and regional management (“control business of the area”: 84) function have a consistently lower-than-average subsidiary size. The results are consistent with our hypothesis that those in support functions have a smaller size compared with those with major functions.

These results provide additional support to Beamish and Inkpen’s (1998) decision to exclude subsidiaries with fewer than 20 employees from analysis due to concerns over non-viable subsidiary organizations that were just agencies or sales offices with a few employees. Those subsidiaries with financing and hedging functions are also small, with an average of 15 employees.

2.5.2 Mode Choice

We hypothesized in Hypothesis 3a that those subsidiaries with market-seeking, natural-resource-seeking, efficiency-seeking, strategic-seeking, and support functions are likely
to choose WOSs over IJVs, while those subsidiaries with labor-seeking purposes are likely to choose IJVs over WOSs. The results generally support our hypothesis.

The main theory linking investment purposes and mode choices is internalization, where the major market failures are asset specificity and information content. MNEs may prefer WOSs over IJVs due to concerns over information content, i.e., protection of their proprietary knowledge and know-how. Another perspective on asset specificity and vertical integration also argues for a preference of WOSs over IJVs because coordination among affiliates and tighter control is needed if a subsidiary is part of the vertical value chain (Kim & Hwang, 1992). However, an IJV will be the preferential ownership mode if local partners are able to provide complementary assets (Beamish & Banks, 1987) and ownership is used as an incentive to local partners (Gil et al., 2006; Yu et al., 2015).

Our data show that those in the resource-seeking categories (A, “natural resources and materials,” and B, “labor intensity”) preferred IJVs over WOSs, which is consistent with the literature (Gil et al., 2006; Yu et al., 2015) in that local partners provided complementary assets to focal MNEs (Beamish & Banks, 1987), although they were part of the vertical value chain of the MNE network. However, other subsidiaries that were also part of the vertical value chain showed a different preference in terms of ownership modes. For example, those subsidiaries in the support functions such as “financing and currency hedging” (J), “information gathering and royalty collection” (K), and “control business of the area” (N) all showed a preference for WOSs over IJVs. One possible explanation is that these functions are vital to the operations of the focal MNE, and local partners can offer few complementary assets.

As no previous research investigated the relationship between efficiency seeking and mode choice, the present study addressed this gap by showing that those subsidiaries established with the purpose of building an international production network showed a preference for IJVs over WOSs, while those with the purpose of building an international distribution network showed a preference for WOSs over IJVs. Although both of these two investments are aimed at improving the efficiency of the MNE network and both are part of the vertical value chain of the MNE, those in the downstream sector, such as sales,
are far more valued than those in the upstream (production) sector. Consistent with prior research (Cui & Jiang, 2009), those in the category of “research and development” (I) showed a preference for WOSs over IJVs because strategic assets such as brands, distribution channels, and technology cannot be fully accessed via an IJV (Rui & Yip, 2008).

Among market seekers, those with the purpose of “local market access” showed a preference for WOSs over IJVs due to concerns with protecting their proprietary knowledge and know-how (Brothers & Hennart, 2007; Anderson & Gatignon, 1986). However, other subgroups in the market-seeking category preferred IJVs over WOSs. For example, those with the purpose of “alliances with customers in Japan” (I) preferred IJVs over WOSs, which is different from the mode choice of U.S. service MNEs expanding abroad by following their clients (Erramilli & Rao, 1990). Erramilli and Rao (1990) suggested that local knowledge was not highly valued in the service industry when MNEs followed their clients in international expansion. In our sample, those in the service industry only accounted for 25% of those following the clients. Local knowledge and complementary assets offered by local partners are indeed valued by MNEs even when they follow their clients abroad when they operate in industries other than the service industry.

With regard to the other two categories of market seekers, both “tax breaks for investment” (C) and “building new business” (M) showed a preference for IJVs over WOSs. For those in the category of “tax breaks for investment,” they invested in the host country due to favorable investment policies offered by the host government. In many cases, governments required investors to establish IJVs in hopes of a positive technology spillover from the focal MNE. Meanwhile, in the case of “building new business” (M) in a non-home-country context, an IJV is also preferred over a WOS. One possible explanation is that there is considerable risk involved in building up a new business in a non-home-country context, and a local partner can share risks and uncertainty associated with a new business.
In sum, TCE arguments still hold in cases when technology, brand, sales, and distribution channels are at stake. Here, WOSs are still preferred over IJVs. However, in cases where local partners can offer supplementary assets and the affiliates are involved in resource- and labor-seeking FDI, IJVs are preferred over WOSs. The findings are consistent with the arguments of the smile of value creation (Mudambi, 2007) and smile-dynamic analysis (Mudambi, 2008), where advanced economies are in control of the two ends of the smile, i.e., R&D, marketing, distribution, and specialized services, while emerging economies are mainly stuck in the manufacturing sector. Our findings show that MNEs operating at the two ends of the smile curve, i.e., R&D, marketing, and distribution, are more likely to prefer WOSs over IJVs, while those in the middle of the curve, i.e., manufacturing, are more likely to choose IJVs over WOSs.

### 2.5.3 Expatriate Control

With regard to expatriate control, we hypothesized in Hypothesis 3b that there is a positive association with vertical FDI and expatriate deployment. This received empirical support. As noted in the literature, expatriates play two primary roles in a subsidiary, i.e., control and knowledge management (Delios & Bjorkman, 2000). Our results are consistent with the literature in that when there is a stronger need for control and coordination, either due to concerns over vertical integration (as in the categories of “natural resources and materials” and “building an international distribution network”) or due to risks involved (as in the category “building new business”), the expat ratio is higher. Meanwhile, those subsidiaries in support functions also showed a greater desire for control (i.e., financing and currency hedging, information gathering and royalty collection, control business of the area). When there is a need for knowledge transfer, the expat ratio is higher than average, i.e., as in the category of research and development.

Moreover, for investments with the purpose of exploiting cheap local labor (i.e., labor intensity and building an international production network), the expat ratio is much lower compared with the group average, although they are also part of the vertical supply chain. In other words, the coordination and control needs among subsidiaries established for vertical integration purposes are different due to the divergent functions they play.
Meanwhile, there is a different need for expats among market seekers. For example, “local market access” has a negative impact on the expat ratio, which is consistent with the literature in that local managers have better knowledge about the local market and it makes good business sense to hire locals instead of sending expats (Beamish & Inkpen, 1998). However, those in the category of “tax breaks for investment” had a lower-than-average expat ratio. One possible explanation is that these are manufacturing subsidiaries. For those that follow their customers in international expansion, this has no effect on the expat ratio, which means that they have an average expat ratio. This suggests that those who venture abroad by following their clients have an average need for control and coordination.

2.5.4 Performance

We hypothesized in Hypothesis 4 that the profitability of the subsidiary is contingent upon the timeframe used to evaluate performance and that those investments with the motive of strategic asset seeking are likely to underperform compared with other types of investments due to the longer time horizon innate in this type of FDI project. This hypothesis received empirical support.

Our results are consistent with Verbeke et al.’s (2009) argument that FDI with different investment purposes is likely to have different performance objectives and different time horizons to achieve those objectives. FDI established for vertical integration purposes such as natural resource seeking (i.e., labor intensity) or efficiency seeking (building an international production network) had a positive effect on the performance evaluation of gain. FDI established for strategic-asset-seeking purposes had a negative effect on performance evaluation. In contrast, FDI in the category of market seeking has a mixed picture. For example, that in the category of “local market access” had a positive effect on performance evaluation, while that in the categories of “tax breaks for investment” and “building new business” had a negative effect. One possible explanation of the negative effect of “building new business” on performance outcome is the risks involved in building new business.
Meanwhile, FDI in the support function had a mixed effect on the performance outcome. FDI in the category of “financing and hedging” had a positive effect, while FDI in regional management functions such as “information gathering” and “control business of area” had a negative effect on performance.

### 2.6 Limitations and Directions for Future Studies

This chapter has limitations. First, it only covered four characteristics and performance measures for each type of investment motive. Future studies can further explore how affiliates differ by other characteristics and performance outcomes such as industry, location, and exit rate, etc. Meanwhile, this chapter only examined the direct relationship between investment purposes and performance outcomes. Future studies can examine whether investment purposes moderate the existing relationships in IB studies and what types of relationships are likely to be moderated by investment purposes. For example, Dhanaraj and Beamish (2004) found that there is a downward curve relationship between ownership level and subsidiary exit rate. It would be interesting to see whether and how this curve differs by each investment purpose.

Second, this analysis is based on FDI that originated in Japan. Future studies can test Dunning’s typology on FDI from other developed countries and emerging economies.

Third, future studies can further explore the theme of heterogeneity among subsidiaries by examining other special categories such as small-employment subsidiaries, i.e., those with fewer than 20 employees. Some of these small-employment subsidiaries have billions of dollars in revenue, which makes it worthwhile to examine how they generate such a large amount of revenue and how they are managed by the headquarters. This question will be considered in Chapter 3.

### 2.7 Preliminary Conclusion

The present study is the first empirical attempt to systematically test Dunning’s (1993) typology on investment motives, using the largest sample ever employed to date. Dunning’s original typology offered definitions and examples for each type of investment motive. This study suggests that Dunning’s typology does have predictive power for key
characteristics (such as size, ownership control, and expatriate control) and performance outcomes. It extends Dunning’s typology by offering theoretical explanations to account for the differences among FDI with divergent investment purposes. It also makes an empirical contribution in that it includes all categories specified in Dunning’s (1993) typology, whereas most previous empirical studies examined only one or two investment purposes in a single study, sometimes in a piecemeal fashion.

Second, this study provides a nuanced picture of FDI in functions such as “financing and hedging,” “information gathering and royalty revenue,” and “building new business,” which have been neglected in most empirical analyses of investment motives (Cuervo-Cazurra & Narula, 2015). These investment motives are not only important in a strategic sense, but also in investment dollars. FDI with these motives is substantially different from other types of FDI and collectively exemplifies the central theme of this dissertation—that there is huge heterogeneity (Birkinshaw & Hood, 2008) among subsidiaries. Hence, there is a need to disaggregate data and treat investments with different investment motives separately. We also argue that where data is available, investment motives should be routinely included in an IB analysis looking at foreign investment.

Third, our results also show that there is a huge difference among subcategories of major investment motives. For example, under the big umbrella of “market-seeking” FDI, there are four subcategories such as “local market access,” “tax breaks for investment,” “alliances with customers in Japan,” and “building new business.” The latter three subcategories are substantially different from the first subcategory in all the four characteristics and performance measures tested in the present research. This suggests that future IB studies should consider investment motives at the subcategory level.

In summary, Dunning’s (1993) typology on investment motives does have predictive power. Due to significant heterogeneity among subsidiaries, special attention should be given to FDI in special categories such as “financing and currency hedging,” “information gathering and royalty collection,” and “building new business” and subcategories of major investment motivations.
References


Chapter 3

3 Subsidiary Size and Survival

This chapter addresses the following two research questions: (1) What is the main relationship between subsidiary size and survival? (2) How is this main effect moderated by the special roles of small-employment subsidiaries? Examples of such roles include serving as centers of importance and serving as a means of vertical investment.

The main theoretical/conceptual lenses used in this chapter are the liability of smallness (Aldrich & Auster, 1986) and orchestration theory (Pitelis & Teece, 2018). It has been argued that there is a high mortality rate for small organizations because they do not have access to resources, especially financial resources. Meanwhile, orchestration theory argues that “MNE operations are not a set of isolated, separable elements. Instead, each MNE is an integrated entity” (Pitelis & Teece, 2018: 532). Thus, subsidiaries are not all equally important within the MNE network. Extending this logic, we found that subsidiaries that have been assigned special roles (such as being centers of importance) within the MNE network have different survival prospects compared with standard subsidiaries.

In our analysis, we examined how a subsidiary’s size influences its exit rate and how this relationship is moderated by small-employment subsidiaries with access to resources. The main statistical tool used in this chapter is a Cox proportional hazards model for survival analysis.

We make at least two contributions to the literature. First, we quantify the liability of smallness by showing the survival likelihood of small-employment subsidiaries. Second, we identify four contingency factors that enhance the survival chances of small-employment subsidiaries. These are the special roles of i) centers of importance, (ii) vertical investment, (iii) being in a human capital-intensive industry, and (iv) being located in a developed country.
3.1 Literature Review

This section reviews the literature on the concepts of the liability of newness (Stinchcombe, 1965) and the liability of smallness (Aldrich & Auster, 1986), followed by the literature on the advantages of larger firms (Josefy, Kuban, Ireland, & Hitt, 2015) and the “small is beautiful” concept (Schumacher, 1974). Afterwards, the relationship between subsidiary size and survival is examined.

3.1.1 Liability of Newness and Liability of Smallness

The seminal work of Stinchcombe (1965) on the “liability of newness” identified a few key internal and external obstacles for new organizations. Internal constraints include the creation of new roles and structures, which might result in temporary inefficiencies. New organizations also face issues in attracting qualified employees. External barriers include competitive pressure from established organizations, which makes entry into a new market or domain prohibitive. The liability of newness might also intersect with the liability of smallness, as new organizations are usually small (Aldrich & Auster, 1986; Bruderl & Schussler, 1990). In addition to co-existing with the liability of newness, the liability of smallness adds additional explanatory power for the high mortality rate of new organizations (Freeman, Carroll, & Hannan, 1983).

Moreover, not all new organizations are born small. Aldrich and Auster (1986) formally formulated the construct of the “liability of smallness.” They argued that smaller organizations face difficulties in raising financial capital, satisfying government tax regulations, competing with larger organizations for qualified employees, and so on. This chapter focuses on the liability of smallness.

Early studies on the liability of smallness focused on the disadvantages of smaller firms, such as the high mortality rate of smaller firms (Baum & Oliver, 1991; Freeman, Carroll, & Hannan, 1983), and the advantages of larger firms, including delivering high-quality goods in a reliable manner (Hanan & Freeman, 1977), accessing financial capital (Aldrich & Auster, 1986), gaining external legitimacy (Baum & Oliver, 1991), and achieving economies of scale (Jovanovic, 1982) and market power (Bain, 1956).
3.1.2 Advantages of Larger Firms

Recent empirical research on firm size has further identified four areas of advantage for larger firms: (1) resources, (2) economies of scale and scope, (3) legitimacy, and (4) market power (Josefy et al., 2015).

3.1.2.1 Resources

Size is closely associated with a firm’s acquired and retained resources. Larger firms enjoy an advantage over smaller ones in terms of absolute resource advantage, slack resources, and valuable capabilities (Josefy et al., 2015).

First, larger firms have an absolute resource advantage over smaller ones, including access to information (Haunschild & Beckman, 1998) and other resources essential to the survival of the organization. As a result, they are more self-reliant and less dependent on external sources, such as director interlocks or alliance partners (Lavie, 2006), for resources. For example, larger firms have better access to information than smaller ones because they have more employees to collect environmental information and have more resources to gather information through other means such as hiring consultants and attending conferences (Haunschild & Beckman, 1998).

Second, there are benefits associated with slack resources, which facilitate larger firms to survive in changing and turbulent environments by initiating strategic change, such as through new product introduction or innovation (Bourgeois, 1981). Due to the availability of slack resources, there is less risk associated with experimenting with new products and new markets, which reduces the failure rate (Hannan & Freeman, 1989). Meanwhile, larger firms are more likely to engage in geographic diversification and enter new markets (Fuentelsaz, Gomez, & Polo, 2002). In addition to product and market diversification, slack resources also provide an advantage for larger firms in innovation because they can recoup R&D expenditures faster due to the greater volume of product sales (Cohen & Klepper, 1996).

Third, in addition to innovation, larger firms are endowed with a number of other valuable capabilities, such as political lobbying and the ability to manage a network of
relationships (Josefy et al., 2015). In investigating the network evolution and quality of knowledge accessed by firms of different sizes in the biotechnology industry, Demirkan, Deeds, and Demirkan (2012) found that larger firms are better at growing their network size due to existing policies and structures of collaborative networks. Meanwhile, larger firms have a greater incentive to engage in political lobbying activities for beneficial public policies for their industry, sometimes even for their own firm (Schuler, 1996; Schuler, Rehbein, & Cramer, 2002). Larger firms benefit disproportionately from the preferential public policies in their industry, although smaller firms can free-ride on the same policies.

3.1.2.2 Economies of Scale and Scope

Larger firms benefit from economies of scale in production and achieve greater efficiency because their unit cost is lower due to the large volume, which constitutes a major competitive advantage for large firms in a single business (Barney, 2002). Dobrev and Carroll (2003) proposed a mechanism for a firm to translate a large production volume into cost efficiencies and suggested that a firm should have the following abilities: “(1) to purchase and make use of specialized manufacturing equipment; (2) to derive savings from operational expansions and quicker pay-back on investments in production facilities and capacity expansion; (3) to promote in-depth employee specialization based on an intricate division of labor; (4) to extract rents from experiential learning and the benefits of high frequency with which the same tasks are carried out; and (5) to reduce per unit overhead costs” (p. 542). Investigating the mortality rates of large organizations in the automobile industry in four major countries, Dobrev and Carroll (2003) found that the largest organizations had lower rates of mortality.

In addition to economies of scale, large organizations also benefit from economies of scope through related diversification and exploiting the synergy between their “strategic assets” (Josefy et al., 2015; Markides & Williamson, 1994). Through related diversification, a firm can expand and create new strategic assets more rapidly and at a lower cost than rivals who are not diversified across related businesses, which also constitutes a competitive advantage of large organizations (Markides & Williamson, 1994).
3.1.2.3 Legitimacy and Status

Having a large size may assist the focal organization in establishing legitimacy among external stakeholders (Pfeffer & Salancik, 1978). However, the result may be confounded by age because size is highly correlated with age (Baum & Oliver, 1991). Meanwhile, as firms age, they may have more opportunities to take actions that help to establish legitimacy among external stakeholders.

Moreover, large firms may enjoy an advantage in technical legitimacy (Ruef & Scott, 1998) and reputation (Staw & Epstein, 2000). Investigating the antecedents of the technical legitimacy of 143 hospital organizations over a 46-year period, Ruef and Scott (1998) found that a larger size is positively associated with technical legitimacy. Size was treated by the latter as a proxy for the ability of an organization to acquire the latest diagnostic and medical resources to achieve technical supremacy.

In addition, larger firms are more visible than their smaller counterparts. As a result, they may receive more attention from external stakeholders such as media and non-governmental organizations (Waddock & Graves, 1997). Nonetheless, they may receive more media scrutiny and lower levels of media support (Deephouse, 1996).

3.1.2.4 Market Power

Compared with smaller firms, larger firms may have greater market power (Josefy et al., 2015). They also tend to possess more market share and can force their suppliers and customers to become price takers (Dobrev & Carroll, 2003).

Larger firms enjoy advantages in terms of resources, economies of scale and scope, legitimacy, and market power. Nonetheless, there are also liabilities associated with largeness, such as increased bureaucracy, inertia/instability, and scrutiny (Josefy et al., 2015). Meanwhile, smaller firms also enjoy certain advantages, as described by Schumacher (1974): “small is beautiful.”
3.1.3 Small Is Beautiful

Small firms have resources and capabilities that differ from those of larger firms. Unlike their larger counterparts, which may face constraints from bureaucracy and organizational inertia, small firms are nimbler and more flexible. They may be better positioned to exploit certain opportunities, such as a growing industry niche (Dean, Brown, & Bamford, 1998).

Meanwhile, small firms may also possess resources for innovation that differ from those of larger firms (King, Covin, & Hegarty, 2003). Although larger firms possess slack resources that are conducive to innovation, smaller firms are less constrained by organizational bureaucracy and may earn greater returns on their R&D investment (Josefy et al., 2015). Individuals are often more creative in small firms, as they exercise greater control over their situational factors (Glynn, 1996). Small firms are also more likely to introduce radical innovation, as they are less constrained by the status quo. Although small firms are more flexible and innovative, they often lack resources to effectively commercialize innovation and frequently seek partnership with larger firms (Josefy et al., 2015).

Moreover, compared to their larger counterparts, who are constrained by structural inertia, small firms are more likely to quickly engage in competitive behavior and execute strategic changes (Chen & Hambrick, 1995).

In addition, larger firms are generally more influential than their smaller counterparts. For instance, larger firms have a greater ability to diffuse innovation (Josefy et al., 2015). However, in certain circumstances, smaller firms can exert a disproportionate influence. For example, when the value of adopting certain organizational practices, such as ISO9000 quality management standards, increases with organizational size, smaller adopters have a greater influence than their larger counterparts over subsequent adoption by other organizations (Terlaak & King, 2007).

Finally, with the advancement of new technology, it is easier for a small firm to raise capital through crowdfunding (Belleflamme, Lambert, & Schwienbacher, 2013) because
traditional sources of funding give preference to larger firms (Aldrich & Auster, 1986). Meanwhile, new technology has also made it easier for small firms to establish legitimacy through social media. For example, small firms can post campaigns, videos, and promotions on social media platforms such as Instagram or Facebook, which can go viral and help the firms obtain support from celebrities or customers (Josefy et al., 2015).

### 3.1.4 Subsidiary Size and Exit

This section first reviews the literature on size and survival, then examines the literature on subsidiary size and survival in international business.

#### 3.1.4.1 Size and Exit

As explained in previous sections, larger firms enjoy several advantages over small firms in terms of access to resources and economies of scale and scope, which helps them survive longer than their smaller counterparts. Larger firms in their initial years survive longer than their smaller counterparts and this effect is almost permanent, as demonstrated by Geroski, Mata, and Portugal (2010) in a large sample of 118,070 new start-up firms from 1983–1993 in Portugal. Meanwhile, larger firms often receive favorable regulatory treatment due to their importance to a national economy, i.e., “too big to fail” (Dobrev & Carroll, 2003), as evidenced by the government bailouts of large financial institutions and large manufacturers by the U.S. government in the 2008 financial crisis (Lien & Klein, 2013).

Meanwhile, small firms also have a survival advantage in industry segments where they are too small to be profitably exploited by large organizations (Dobrev, 2000). Dobrev and Carroll (2003), in studying automobile manufacturers in Britain, France, Germany, and the United States from 1885 to 1981, found that firms at both ends of the relative size spectrum enjoyed a survival advantage. The results on small firms are also supported by separate studies. Agarwal and Audretsch (2001) found that the likelihood of survival for small firms was generally lower than for their larger counterparts. However, the same relationship does not hold for mature stages of the product lifecycle (Agarwal, Sarkar, & Echambadi, 2002) or technology-intensive products because small players can successfully fill a strategic niche.
3.1.4.2 Subsidiary Size and Exit

The size of a subsidiary is a proxy for the tangible and intangible resources available to it (Penrose, 1995; Johnston & Menguc, 2007). There are few empirical studies using subsidiary size as the main predictor. One of the few exceptions is Johnston and Menguc (2007), who examined the relationship between subsidiary size and the level of subsidiary autonomy and found a quadratic inverted U-shaped relationship.

There is even less empirical research on the relationship between subsidiary size and exit. Delios and Ensign (2000) investigated Japanese investment in Canada, and subsidiary size was one of the main predictors. Subsidiary size measured by the log of capital invested was negatively associated with the likelihood of exit. In most empirical studies on subsidiary exit, subsidiary size was added as a control variable (e.g., Getachew & Beamish, 2017). Our study addresses this empirical gap by systematically investigating the relationship between subsidiary size and survival, with a particular focus on small subsidiaries.

3.2 Theoretical Framework

3.2.1 Main Effect of Subsidiary Size

MNEs have access to and use resources such as financial capital, managerial talent, and knowledge (Johnston & Menguc, 2007). Hedlund (1981) suggested that a large subsidiary has greater resources than a small subsidiary, which was supported empirically (Prahalad & Doz, 1981). Because there is a negative association between resources and rate of exit (Aldrich & Auster, 1986; Baum & Oliver, 1991; Freeman, Carroll, & Hannan, 1983), size is thought to have a negative effect on mortality. Hence, we have the following hypothesis:

**Hypothesis 1:** Smaller subsidiaries have a higher exit rate than larger ones.

In the following section, four contingency factors are proposed to moderate the main effect. The first contingency factor is the type of resource (Pfeffer & Salancik, 1978) owned by small subsidiaries, where “centers of importance” command higher status in the MNE network. The second factor is vertical versus horizontal FDI (Slangen &
Beugelsdijk, 2010). The third factor is being in a human capital-intensive industry (Silk & Berndt, 1993), where larger firms do not necessarily enjoy the cost-saving advantages of economies of scale and scope. The fourth factor is environmental factors at the national level that attenuate the liability of smallness (Stinchcombe, 1965).

3.2.2 Centers of Importance

There are four main types of MNE activity, i.e., natural resource seekers, market seekers, efficiency seekers, and strategic asset or capability seekers (Dunning & Lundan, 2008). In addition, there are other motives for MNE activity, such as escape investments, support investments, and passive investments. This chapter focuses on support investments, where the very purpose of subsidiaries is to support the MNE network of which they are part (Dunning & Lundan, 2008).

Subsidiaries that are set up for support investments are often cost centers instead of being self-contained profit centers. They incur costs and create benefits for the rest of the MNE network. Most of these support investments are trade- and finance-related investments of MNEs, and aim to facilitate the export of goods and the purchase of raw materials from other companies. These activities are often the first step in setting up market- or resource-seeking production facilities (Dunning & Lundan, 2008). Others are regional headquarters with various functions, such as coordinating the activities of operating units and collecting marketing and financial information for the parent firm. They often act as a “listening and monitoring arm” of the parent firm (Dunning & Lundan, 2008).

Borrowing from the concept of “centers of excellence” (Frost, Birkinshaw, & Ensign, 2002), we coin the term “centers of importance” to describe these support investments. We define a “center of importance” as a non-regular organizational unit with a set of resources and capabilities serving the functioning of the MNE network as a whole. These “centers of importance” include subsidiaries for support investments, new business development, and strategic asset-seeking activities. As argued by orchestration theory, not all subsidiaries are equally important within an MNE network (Pitelis & Teece, 2018). Because centers of importance own resources that are strategically important to the MNE network, they are likely to command a higher status compared with regular
subsidiaries (Pfeffer & Salancik, 1978). As a result, the MNE parent firms are likely to devote more attention and resources (Hedlund, 1981) to these subsidiaries. Meanwhile, as these centers are designed as cost centers, their profitability may not be relevant to their survival.

Small subsidiaries established for support function purposes own resources critical to the MNE network. MNE parent firms are likely to devote more attention to these affiliates and incur more costs for their survival. As a result, they have a lower mortality rate than small affiliates without such functions because they have these extra resources and attention from MNE parent firms. Hence, we put forward the following hypothesis:

**Hypothesis 2:** Small subsidiaries designed as “centers of importance” have a lower exit rate compared with subsidiaries established for other purposes.

### 3.2.3 Vertical versus Horizontal FDI

Exploratory studies on the divestment decisions of big firms suggest that small units that do not enjoy synergy with other units are more likely to be divested (Duhaime & Baird, 1987). In addition to classifying FDI along the main typologies of investment purposes, these investments can also be categorized along two other dimensions: vertical investment and horizontal investment (Beugelsdijk, Smeets, & Zwinkels, 2008; Caves, 2007; Kobrin, 1976; Slangen & Beugelsdijk, 2010; Zaheer, 1995). Horizontal investments are standalone affiliates with the main purpose of local market seeking. They often sell products to unaffiliated customers and perform all value chain activities starting from raw material procurement to production and sales (Caves, 2007; Zaheer, 1995). They may operate rather independently of their parent firms and sister subsidiaries and are well embedded in their local environment (Kobrin, 1976; Prahalad & Doz, 1987).

On the other hand, vertical investments often perform part of the value chain activity and sell their output to affiliated subsidiaries for further processing or final sales (Caves, 2007; Zaheer, 1995). They are part of the interlinked MNE network and seek to take advantage of inter-country differences in terms of natural resources and inexpensive labor (Dunning & Lundan, 2008; Kobrin, 1991; Nachum & Zaheer, 2005). Because vertical
affiliates are often supplied by sister subsidiaries instead of local suppliers and because they sell their output to affiliated rather than unaffiliated customers, they are more tightly integrated with the rest of the MNE network than horizontal affiliates (Prahalad & Doz, 1987).

Because small subsidiaries that are set up for the purpose of vertical FDI are more tightly integrated with the MNE network than standalone horizontal FDI, we expect that small vertical subsidiaries have greater synergy with the rest of the MNE network and are less likely to be divested. Hence, we hypothesize the following:

**Hypothesis 3:** Small vertical subsidiaries have a lower exit rate than small horizontal subsidiaries.

### 3.2.4 Human Capital-Intensive Industry

As discussed earlier, larger firms enjoy economies of scale and scope over smaller firms, thus entailing a cost advantage in traditional labor-intensive industries such as manufacturing (Josefy et al., 2015). In traditional industries, small firms partially overcome the liability of smallness (and the frequently high exit rate) by occupying a strategic niche (Agarwal & Audretsch, 2001; Agarwal et al., 2002). However, in human capital-intensive industries where clients receive professional services, such as law, consulting, advertising, and accounting, both very large and very small firms persist (von Nordenflycht, 2011). The following discussion is limited to why very small firms exist and persist in human capital-intensive industries.

First, small firms in those industries do not necessarily suffer a cost disadvantage because there is a very low threshold for scale economies. For example, in the advertising industry, $3 million or $4 million in annual revenue is enough to achieve economies of scale (Silk & Berndt, 1993). Second, even if operating at 50% below that threshold, the cost disadvantage incurred is less than 5% (Silk & Berndt, 1995). Third, most firms in those industries operate across a wide scope, which has made economies of scope an industry norm, rather than an exception enjoyed only by large firms (Silk & Berndt, 1995).
As a result, there is less of a liability of smallness (hence, a lower exit rate) in human capital-intensive industries compared with small firms in traditional industries. Hence, we hypothesize the following:

**Hypothesis 4:** Small subsidiaries in human capital-intensive industries have a lower exit rate compared with small subsidiaries in other industries.

### 3.2.5 Developed versus Developing Countries

The FDI literature suggests that developed countries and developing countries differ significantly in terms of both institutional environments and macroeconomic conditions (Beamish, 1985; 1993; Getachew & Beamish, 2017). In general, developed countries have better institutional support and mature market infrastructure, while developing countries are characterized by weak institutional support and high market growth potential.

First, in terms of the institutional environment, developed countries provide stronger property rights protection and law enforcement, high levels of general literacy, and a mature market economy infrastructure (Makino et al., 2004). In contrast, developing countries are characterized by “institutional voids” (Santangelo & Meyer, 2011) where market-supporting institutions are weak (Mair & Marti, 2009) or absent. Developing countries also suffer from “institutional instability” due to sudden changes of government (Zoogah, Peng, & Woldu, 2015) or war and conflict (Dai, Eden, & Beamish, 2013; 2017). Empirical studies suggest that foreign subsidiaries have a higher exit rate from developing countries such as African nations than their counterparts in developed countries such as OECD nations (e.g., Getachew & Beamish, 2017).

Second, macroeconomic conditions affect the likelihood of firm survival for several reasons (Geroski et al., 2010). First, under unfavorable macroeconomic conditions, firms have pessimistic perceptions of future economic development and are more likely to exit than during economic booms. Second, during economic recessions, many firms face cash constraints and struggle to secure financial resources even if they intend to stay in business. Using the gross domestic product (GDP) growth rate as a proxy for a favorable
macroeconomic environment, Geroski et al. (2010) found a negative association between GDP growth rate and firm exit.

Moreover, during economic recessions, new and small firms are more likely to exit than their larger counterparts because the problem of cash constraints is more severe for them than for established firms (Cabral & Mata, 2003). New and small firms have less time to establish legitimacy and secure financial resources (Diamond, 1989).

Although developing countries have higher economic growth potential, general macroeconomic conditions are better in developed countries than in developing countries. In addition, developed countries have better fiscal policies than developing ones. As a result, small subsidiaries are less likely to go out of business, because it is also much easier for them to access financial resources due to favorable fiscal policies. As a result, MNE parent firms are less likely to divest small subsidiaries in developed countries than in developing countries. Thus, we put forward the next hypothesis:

**Hypothesis 5:** *Small subsidiaries in developed countries have a lower exit rate than their counterparts in developing countries.*

### 3.3 Methodology

#### 3.3.1 Data and Sample

We used the Toyo Keizai dataset, which covers Japanese investment from 1991 to 2017. The Toyo Keizai annually surveys general managers of all Japanese subsidiaries in which a parent firm is listed on a major stock exchange in Japan. Although the survey is exhaustive of all overseas investment of Japanese parent firms that respond to the annual survey, it is estimated that the Toyo Keizai dataset’s coverage is close to only 40% of all Japanese FDI (Delios & Ensign, 2000). The Toyo Keizai dataset has been used in more than 120 high-quality journal publications. It covers 56,193 Japanese overseas subsidiaries in 164 countries by 8,318 Japanese parent firms.
3.3.2 Measures

3.3.2.1 Dependent Variable

The dependent variable is the exit rate of an overseas subsidiary. A dummy variable is used to indicate the exit status of a subsidiary in each year. This variable is coded as 1 if a subsidiary exited from the database and 0 otherwise.

3.3.2.2 Independent Variables

The main independent variable is a subsidiary’s size. It is measured by the number of employees in each subsidiary. Unlike previous studies that log transform the number to achieve a normal distribution of the variable (e.g., Getachew & Beamish, 2017), we categorize this variable so that those subsidiaries with zero employees can still be included in our analysis. A preliminary descriptive analysis shows that 40 is the median number of employees, while 234 is the mean number of employees. Moreover, 20 has been used as the cut-off point for firms with a small number of employees, a group that has been routinely excluded from data analysis in the IB literature (Beamish & Inkpen, 1998). In addition, we intend to gain a nuanced understanding of small subsidiaries with fewer than 20 employees, and thus we further divided subsidiaries in this category. Taking all these factors into consideration, we divided the subsidiaries into seven categories, i.e., (1) zero employees; (2) between 1 and 5 employees; (3) between 6 and 10 employees; (4) between 11 and 19 employees; (5) between 20 and 40 employees; (6) between 41 and 234 employees; and (7) 235 or more employees. As shown in Table 12, the largest category belongs to those with between 41 and 234 employees (31%), while around 10% subsidiaries have zero employees; 20% of subsidiaries have between 1 and 5 employees; 16% of subsidiaries have between 6 and 10 employees; another 16% of subsidiaries have between 11 and 19 employees; 20% of subsidiaries have between 20 and 40 employees; and 17% of subsidiaries have 235 or more employees.\textsuperscript{18}

\textsuperscript{18} As the number of employees of a particular subsidiary changes, the subsidiary can fall into multiple categories. As a result, the percentages of the numbers of subsidiaries add up to more than 100%.
Four contingency factors were also identified in hypotheses 2, 3, 4, and 5. The first factor is a subsidiary’s status of “center of importance.” As discussed previously, “centers of importance” include support investments, new business development, and strategic asset seeking. Those subsidiaries with support investment motives such as “financing and currency hedging,” “information gathering,” and “control business of the area” are coded as 1. Meanwhile, those with the investment motive of “new business development” or “research and development” are also coded as 1. If a subsidiary has none of the abovementioned investment motives, it is coded as 0.

**Table 12: Number of subsidiary-years and subsidiaries in each cell**

<table>
<thead>
<tr>
<th>Category</th>
<th>No. of subsidiary-years</th>
<th>(%)</th>
<th>No. of subsidiaries</th>
<th>(%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Zero employees</td>
<td>22,261</td>
<td>4.00</td>
<td>5,790</td>
<td>10.30</td>
</tr>
<tr>
<td>1–5 employees</td>
<td>52,315</td>
<td>9.39</td>
<td>10,946</td>
<td>19.48</td>
</tr>
<tr>
<td>6–10 employees</td>
<td>37,721</td>
<td>6.77</td>
<td>9,144</td>
<td>16.27</td>
</tr>
<tr>
<td>11–19 employees</td>
<td>38,526</td>
<td>6.91</td>
<td>9,087</td>
<td>16.17</td>
</tr>
<tr>
<td>20–40 employees</td>
<td>54,930</td>
<td>9.86</td>
<td>11,389</td>
<td>20.27</td>
</tr>
<tr>
<td>41–234 employees</td>
<td>123,283</td>
<td>22.13</td>
<td>17,176</td>
<td>30.57</td>
</tr>
<tr>
<td>235 or more employees</td>
<td>77,246</td>
<td>13.86</td>
<td>9,276</td>
<td>16.51</td>
</tr>
<tr>
<td>Missing</td>
<td>150,897</td>
<td>27.08</td>
<td>30,844</td>
<td>54.89</td>
</tr>
<tr>
<td>Total</td>
<td>557,179</td>
<td>100.00</td>
<td>56,193</td>
<td>100.00</td>
</tr>
</tbody>
</table>

Second, those subsidiaries with the investment purpose of “natural resources and materials” are coded as 1 for “vertical investment” and 0 otherwise.

Third, “human capital-intensive industry” is indicated by the industry sector of the subsidiary. Those in the industry sectors of “finance, insurance and real estate,”

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19 As the number of employees of a particular subsidiary changes, the subsidiary can fall into multiple categories. As a result, the percentages of the numbers of subsidiaries add up to more than 100%. The number of subsidiaries entries add up to more than 56,193.
“investment company,” “retail,” “services,” or “wholesale trade” are coded as 1 and 0 otherwise.

Fourth, we defined developed countries versus developing countries using the country classification of the United Nations (Makino et al., 2004). This broadly defined countries as falling under three categories: developed economies, developing economies, and least developed countries. Because the sample size of the least developed countries is conspicuously small (only accounting for 0.5% of all subsidiaries), we combined the categories of developing economies and least developed countries. A country is coded as 1 if it is a developed country and 0 otherwise.

3.3.2.3 Control Variables

To rule out other potential explanations, we controlled for several variables at the subsidiary, parent firm, and country levels. First, at the subsidiary level, we controlled for two variables that have been found to be theoretically related to subsidiary exit. We controlled for subsidiary age, as younger firms have a higher exit rate than their older counterparts (Getachew & Beamish, 2017; Carroll & Delacroix, 1982). We also controlled for the ownership level of the parent firm, as a higher ownership level is associated with a lower exit rate (Dhanaraj & Beamish, 2004; Getachew & Beamish, 2017). This is operationalized by the first Japanese parent firm’s ownership level.

Second, at the parent firm level, we controlled for the number of Japanese parents. As multiple parent firm companies will lead to managerial complexity, which improves exit (Makino & Beamish, 1998). We also controlled for parent firm size, by the log transformation of its net sales.

Third, at the country level, we controlled for the GDP growth rates of the host countries. Higher GDP growth in a host society is negatively correlated with subsidiary survival rates (Thomas, Eden, Hitt, & Miller, 2007). We obtained these data from the World Development Indicators. We also controlled for the cultural distance between the host country and home country, as previous studies have found that it positively affects
subsidiary mortality (Barkema et al., 1997; Zeng et al., 2013). This variable is measured by the cultural distance index developed by Kogut and Singh (1988).

3.3.3 Model Specifications

With regard to the statistical model, we used event history analysis (EHA) to examine the hazard of the exit of a subsidiary. A Cox proportional hazards model was applied with time-varying variables (Cox & Oakes, 1984). “Robust” and “cluster” STATA procedures were used to estimate a robust coefficient covariance matrix and control for possible dependence among FDI initiated by the same MNE.

3.4 Analysis and Results

The descriptive statistics and correlations among all variables are provided in Table 13. On average, the exit rate is 5%. About 12% of all subsidiaries command the status of “center of importance.” Between 1.5 and 2% of all subsidiaries are engaged in vertical investment. About 50% of subsidiaries are in a human capital-intensive industry, and 37% of subsidiaries are limited to developed countries.

Tables 14 to 18 present the results of our analysis. First, Table 14 shows the result of the main hypothesis, i.e., the effect of subsidiary size on exit. The detailed results are as follows. Compared with the reference category, i.e., 235 employees or more, those subsidiaries with zero employees are 7.6 times more likely to exit. Those with between 1 and 5 employees are 5.0 times more likely to exit. Those with between 6 and 10 employees are 3.3 times more likely to exit. Those with between 10 and 19 employees are 2.4 times more likely to exit. Those with between 20 and 40 employees are 2.2 times more likely to exit. Those with between 41 and 234 employees are 1.5 times more likely to exit. Thus, hypothesis 1 is supported.

Our second hypothesis presents a moderating effect of “centers of importance” on the relationship between subsidiary size and subsidiary exit. Table 15 provides useful estimates in testing this prediction. We find that those small subsidiaries with a number of employees between 6 and 40 have a significantly lower exit rate if they have been assigned the role of “center of importance.” Thus, hypothesis 2 is supported.
Table 16 presents the results for a test of H3, which predicts a negative moderating effect of vertical investment on the relationship between subsidiary size and exit. The signs of moderating coefficients are all negative when the investment motive of natural resource seeking is used as a proxy for vertical investment. Those small subsidiaries with between 1 and 5 employees have a significantly lower hazard ratio—that is, 2.2 versus 5.0.

Hypothesis 4 suggests that small subsidiaries in human capital-intensive industries have a lower exit rate. Table 17 presents the results. The signs of all moderating coefficients are negative and significant. Small subsidiaries in all size categories have a lower exit rate if they are in a human capital-intensive industry. Thus, hypothesis 4 is fully supported.

Finally, Table 18 shows the moderating effect of being a developed country versus a developing country. In general, the signs of the coefficients of the interaction terms are positive and not significant, which means that there is no significant difference in terms of the exit rate for small subsidiaries. However, only those subsidiaries with zero employees have a significantly lower exit rate when they are located in a developed country (5.8 versus 10.2). Thus, hypothesis 5 is marginally supported.

Last, all control variables are significant predictors of subsidiary mortality, except for GDP growth rate. As expected, subsidiary age and the first Japanese parent firm’s ownership level have a significantly negative impact on the subsidiary exit rate. However, the number of Japanese parent firms lowers the exit rate and the size of the MNE improves the exit rate. With regard to the variable of cultural distance, it is negative and significant. MNEs tend to exercise greater ownership control when there is more cultural distance between the host and home countries (Anand & Delois, 1997), which lowers the exit rate of subsidiaries.
Table 13: Mean and correlation matrix

<table>
<thead>
<tr>
<th></th>
<th>Mean</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
<th>6</th>
<th>7</th>
<th>8</th>
<th>9</th>
<th>10</th>
<th>11</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Exit</td>
<td>0.05</td>
<td>1.00</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2 Center of importance</td>
<td>0.12</td>
<td>-0.01</td>
<td>1.00</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3 Vertical investments</td>
<td>0.02</td>
<td>0.00</td>
<td>0.08</td>
<td>1.00</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>4 Human capital-intensive industry</td>
<td>0.50</td>
<td>0.03</td>
<td>0.11</td>
<td>-0.07</td>
<td>1.00</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>5 Developed country</td>
<td>0.37</td>
<td>0.04</td>
<td>0.08</td>
<td>-0.01</td>
<td>0.23</td>
<td>1.00</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>6 Subsidiary age</td>
<td>14.00</td>
<td>-0.02</td>
<td>-0.04</td>
<td>-0.00</td>
<td>0.03</td>
<td>0.14</td>
<td>1.00</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>7 First Japanese parent ownership level</td>
<td>60.10</td>
<td>-0.05</td>
<td>0.16</td>
<td>0.02</td>
<td>0.10</td>
<td>0.00</td>
<td>0.01</td>
<td>1.00</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>8 Number of Japanese parents</td>
<td>1.25</td>
<td>-0.01</td>
<td>0.02</td>
<td>0.05</td>
<td>-0.15</td>
<td>-0.12</td>
<td>-0.05</td>
<td>-0.13</td>
<td>1.00</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>9 Parent firm size</td>
<td>12.94</td>
<td>0.06</td>
<td>-0.16</td>
<td>-0.02</td>
<td>0.05</td>
<td>0.07</td>
<td>0.10</td>
<td>-0.19</td>
<td>0.05</td>
<td>1.00</td>
<td></td>
<td></td>
</tr>
<tr>
<td>10 Cultural distance</td>
<td>3.32</td>
<td>-0.01</td>
<td>0.02</td>
<td>-0.00</td>
<td>-0.01</td>
<td>-0.19</td>
<td>-0.04</td>
<td>0.07</td>
<td>0.02</td>
<td>-0.03</td>
<td>1.00</td>
<td></td>
</tr>
<tr>
<td>11 GDP growth rate</td>
<td>4.46</td>
<td>-0.02</td>
<td>-0.05</td>
<td>0.01</td>
<td>-0.19</td>
<td>-0.48</td>
<td>-0.21</td>
<td>0.01</td>
<td>0.06</td>
<td>-0.06</td>
<td>0.19</td>
<td>1.00</td>
</tr>
</tbody>
</table>
### Table 14: Main effect of subsidiary size on survival

<table>
<thead>
<tr>
<th>Subsidiary size</th>
<th>Hazard ratio</th>
</tr>
</thead>
<tbody>
<tr>
<td>Zero employees</td>
<td>7.6***</td>
</tr>
<tr>
<td>1–5 employees</td>
<td>5.0***</td>
</tr>
<tr>
<td>6–10 employees</td>
<td>3.3***</td>
</tr>
<tr>
<td>11–19 employees</td>
<td>2.4***</td>
</tr>
<tr>
<td>20–40 employees</td>
<td>2.2***</td>
</tr>
<tr>
<td>41–234 employees</td>
<td>1.5***</td>
</tr>
<tr>
<td>Reference category: 235 or more employees</td>
<td></td>
</tr>
</tbody>
</table>

**Control variable**

<table>
<thead>
<tr>
<th>Control variable</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Subsidiary age</td>
<td>0.8***</td>
</tr>
<tr>
<td>First Japanese parent ownership level</td>
<td>1.0***</td>
</tr>
<tr>
<td>Number of Japanese parents</td>
<td>0.9***</td>
</tr>
<tr>
<td>Parent firm size</td>
<td>1.2***</td>
</tr>
<tr>
<td>Cultural distance</td>
<td>1.0**</td>
</tr>
<tr>
<td>GDP growth rate</td>
<td>1.0</td>
</tr>
</tbody>
</table>

*Note: ***p<0.001, **p<0.01, *p<0.05*
Table 15: Moderating effect of “center of importance” on subsidiary survival

<table>
<thead>
<tr>
<th>Subsidiary size</th>
<th>Hazard ratio (center of importance sample)</th>
<th>Hazard ratio (non-center of importance sample)</th>
<th>Coefficient of interaction term</th>
</tr>
</thead>
<tbody>
<tr>
<td>Zero employees</td>
<td>6.3</td>
<td>7.3</td>
<td>−0.17</td>
</tr>
<tr>
<td>1–5 employees</td>
<td>3.4</td>
<td>4.9</td>
<td>−0.31</td>
</tr>
<tr>
<td>6–10 employees</td>
<td>1.9</td>
<td>3.4</td>
<td>−0.49*</td>
</tr>
<tr>
<td>11–19 employees</td>
<td>1.3</td>
<td>2.4</td>
<td>−0.58**</td>
</tr>
<tr>
<td>20–40 employees</td>
<td>1.2</td>
<td>2.2</td>
<td>−0.54**</td>
</tr>
<tr>
<td>41–234 employees</td>
<td>1.1</td>
<td>1.5</td>
<td>−0.27</td>
</tr>
<tr>
<td>Reference category: 235 or more employees</td>
<td>1</td>
<td>1</td>
<td></td>
</tr>
</tbody>
</table>

Note: *** p<0.001, ** p<0.01, *p<0.05; control variables included

Table 16: Moderating effect of vertical investment on subsidiary survival

<table>
<thead>
<tr>
<th>Subsidiary size</th>
<th>Hazard ratio (vertical investment sample)</th>
<th>Hazard ratio (non-vertical investment sample)</th>
<th>Coefficient of interaction term</th>
</tr>
</thead>
<tbody>
<tr>
<td>Zero employees</td>
<td>5.3</td>
<td>7.6</td>
<td>−0.29</td>
</tr>
<tr>
<td>1–5 employees</td>
<td>2.2</td>
<td>5.0</td>
<td>−0.72*</td>
</tr>
<tr>
<td>6–10 employees</td>
<td>2.4</td>
<td>3.3</td>
<td>−0.21</td>
</tr>
<tr>
<td>11–19 employees</td>
<td>1.0</td>
<td>2.4</td>
<td>−0.75</td>
</tr>
<tr>
<td>20–40 employees</td>
<td>1.9</td>
<td>2.1</td>
<td>−0.14</td>
</tr>
<tr>
<td>41–234 employees</td>
<td>1.5</td>
<td>1.4</td>
<td>0.09</td>
</tr>
<tr>
<td>Reference category: 235 or more employees</td>
<td>1</td>
<td>1</td>
<td></td>
</tr>
</tbody>
</table>

Note: *** p<0.001, ** p<0.01, *p<0.05; control variables included
Table 17: Moderating effect of human capital-intensive industry on subsidiary survival

<table>
<thead>
<tr>
<th>Subsidiary size</th>
<th>Hazard ratio (human capital-intensive industry sample)</th>
<th>Hazard ratio (non-human-capital-intensive industry sample)</th>
<th>Coefficient of interaction term</th>
</tr>
</thead>
<tbody>
<tr>
<td>Zero employees</td>
<td>5.6</td>
<td>9.4</td>
<td>−0.40*</td>
</tr>
<tr>
<td>1–5 employees</td>
<td>3.7</td>
<td>5.9</td>
<td>−0.32*</td>
</tr>
<tr>
<td>6–10 employees</td>
<td>2.4</td>
<td>4.3</td>
<td>−0.42**</td>
</tr>
<tr>
<td>11–19 employees</td>
<td>1.7</td>
<td>3.2</td>
<td>−0.51**</td>
</tr>
<tr>
<td>20–40 employees</td>
<td>1.5</td>
<td>2.8</td>
<td>−0.51**</td>
</tr>
<tr>
<td>41–234 employees</td>
<td>1.1</td>
<td>1.6</td>
<td>−0.30*</td>
</tr>
</tbody>
</table>

Reference category: 235 or more employees

Note: *** p<0.001, ** p<0.01, *p<0.05; control variables included

Table 18: Moderating effect of country development stage on subsidiary survival

<table>
<thead>
<tr>
<th>Subsidiary size</th>
<th>Hazard ratio (developed country sample)</th>
<th>Hazard ratio (developing country sample)</th>
<th>Coefficient of interaction term</th>
</tr>
</thead>
<tbody>
<tr>
<td>Zero employees</td>
<td>5.8</td>
<td>10.2</td>
<td>−0.44**</td>
</tr>
<tr>
<td>1–5 employees</td>
<td>4.2</td>
<td>5.4</td>
<td>−0.07</td>
</tr>
<tr>
<td>6–10 employees</td>
<td>3.1</td>
<td>3.3</td>
<td>0.06</td>
</tr>
<tr>
<td>11–19 employees</td>
<td>2.5</td>
<td>2.2</td>
<td>0.22</td>
</tr>
<tr>
<td>20–40 employees</td>
<td>2.2</td>
<td>2.1</td>
<td>0.15</td>
</tr>
<tr>
<td>41–234 employees</td>
<td>1.6</td>
<td>1.3</td>
<td>0.10</td>
</tr>
</tbody>
</table>

Reference category: 235 or more employees

Note: *** p<0.001, ** p<0.01, *p<0.05; control variables included
3.5 Discussion

This study was motivated by our intention to contribute to understanding the conditions under which small-employment subsidiaries may have a better survival outcome.

Extending the literature on the liability of smallness (Aldrich & Auster, 1986), we examined the effect of subsidiary size on survival. Using a sample of Japanese overseas FDI, we offer a nuanced picture of the effect, i.e., smaller subsidiaries have a higher exit rate than larger ones. We also quantified the effect.

Furthermore, we found that the liability of smallness is conditional upon the specific roles of the subsidiary, industry features, and country-level characteristics. Specifically, we found that subsidiaries that have been assigned the role of center of importance have a lower exit rate than their counterparts of a similar size without such a role. This provides additional empirical support to orchestration theory’s argument that an MNE operates like an integrated entity, instead of being a set of isolated and separable elements (Pitelis & Teere, 2018).

Moreover, we found that small subsidiaries with the function of vertical investment have a lower exit rate than their counterparts without such a function, especially when the subsidiary is extremely small (0–5 employees). Being tightly integrated within the MNE network improves the survival chances of small subsidiaries. This result differs from Getachew and Beamish’s (2017) study on the moderating effect of horizontal investment on the relationship between entry into Africa and exit. They found that market-seeking FDI has a better survival outcome than horizontal FDI because it is more tightly integrated with the local environment, including suppliers and customers. This study offers a new perspective on the conditions under which vertical investment has a better chance of survival.

In addition, we identified the third contingency factor of human capital-intensive industries. This study provides additional empirical evidence that being small is not much of a liability when the subsidiary is in such human capital-intensive industries as “finance, insurance and real estate,” “retail,” “service,” “wholesale,” or “investment
companies.” As these industries have a low threshold for scale economies (Silk & Berndt, 1993; 1995), small subsidiaries in them have a lower exit rate compared with their counterparts of a similar size in other industries.

Finally, this study provides marginal support to the notion that being located in a developed country lowers the exit rate, which is different from Getachew and Beamish’s (2017) argument that being located in Africa increases the exit rate. Only those subsidiaries with zero employees have a significantly lower exit rate in developed countries. One explanation is that some subsidiaries are set up as financial instruments, serving special purposes. Other than that, there is no significant difference in terms of exit rate for subsidiaries of similar sizes.

3.6 Limitations and Directions for Future Studies

This study is not without limitations. First, because of data constraints, the results are based on Japanese FDI. Investment from other countries may differ. Second, results are based on a quantitative survey of subsidiary managers. Additional qualitative studies from the MNE parent firm level may provide insights on contingency patterns.

Future directions of study include investigating other contingency factors for the survival of small-employment subsidiaries. Meanwhile, researchers should investigate subsidiaries with zero employees. The finance literature has firmly established that there are special purpose vehicles (SPVs) that are “essentially robot firms that have no employees, make no substantive economic decisions, have no physical location, cannot go bankrupt” (Gorton & Souleles, 2007: 550). As a result, there is a category of zero-employee subsidiaries. In the analysis of zero-employee subsidiaries in the TK dataset, we included all observations with the record of zero in a particular year as a proxy of zero-employee subsidiaries. However, this practice may accidentally include missing values for this variable in the dataset. Future analysis can mitigate this problem by jointly considering the number of employees over the life cycle of the subsidiary, the investment motive as well as the industry of the subsidiary so as to cross-check whether it is a missing value.
Finally, those subsidiaries with extremely large sizes are lumped together with other subsidiaries of 235 or more employees. It might be worthwhile to treat those extremely large subsidiaries as a special category and investigate their key features.
References


Chapter 4

4 Crisis Response by MNEs: The 2008 Consumer Confidence Crisis in China

4.1 Introduction

How do multinational enterprises react when one of their overseas markets is affected by a domestic consumer confidence crisis? Theoretically, three considerations should affect their response. First, foreign-owned companies and foreign brands may be better able to disassociate themselves from the sources of the consumer confidence crisis, and hence they face opportunities to increase their market share vis-à-vis domestic competitors. Second, foreign owners may become more concerned about the standards of operations within their own operations: the confidence crisis will lead to greater scrutiny of what firms actually do in their operations. To this challenge, they are likely to respond with a stronger focus on organizational control and compliance with the MNE’s quality assurance processes. Third, MNEs may be concerned that an association with the industry and country of the crisis may affect their global reputation. In consequence, they may want to exit the country, especially if they are unable to ensure compliance with their quality assurance processes.

Based on these three considerations, we explore the impact of a consumer confidence crisis on the strategies of foreign investors with respect to entry, exit, and ownership change. Specifically, we investigate how a consumer confidence crisis influences a) foreign entry, b) foreign exit, and c) equity stakes held by foreign investors, with a special focus on different responses in manufacturing and services. Moreover, we investigate how changes in equity stakes vary across ownership categories (i.e., WOS, majority equity, and minority equity).

In developing our hypotheses and empirical tests, we apply and extend several lines of theory in international business. First, we draw on the theoretical lens of transaction cost economics (TCE) (Coase, 1937; Williamson, 1975; Hennart, 1982), especially literature concerned with the governance of MNEs (e.g., Chen, Paik, & Park, 2010; Yan & Gray, 2001). Second, we draw on institutional theory, especially the concepts of legitimacy and
reputation (Kostova & Zaheer, 1999; Rao, 1994), to explain the relative advantages of foreign and local firms facing a crisis. In doing so, we also draw on the concept of country of origin, which stipulates that an investor’s national origin affects their perception by consumers (e.g., Knight, Holdsworth, & Mather, 2007; Usunier, 2006; Verlegh, 2007; Zhou & Hui, 2003). Contrary to other recent studies in China (e.g., Zhang & Luo, 2013; Zhao, Park, & Zhou, 2014), we argue that foreign firms may actually face enhanced legitimacy as a result of the crisis.

We empirically test hypotheses about the impact of a consumer confidence crisis on the food sector—an industry that is highly culturally embedded and therefore tends to lead to consumer preferences for domestically sourced products (Usunier, 2006; Yasuda, 2015). At the same time, consumers have concerns about violations of health and safety standards in food products because any such violations can directly impact their personal health. Such health concerns can compensate for consumer ethnocentrism and provide opportunities for foreign investors. Our hypotheses focus on the differences in responses at the time of a consumer confidence crisis with respect to the difference between investors in the food sector and foreign investors in general, with an emphasis on the manufacturing and service segments.

For the empirical context, we chose the baby formula milk scandal that hit China in 2008. This scandal triggered increasing awareness among Chinese consumers that despite impressive economic growth and other achievements, product safety—and food safety in particular—was still a major concern in China (Beamish & Bapuji, 2008; Luo, 2008; Wu & Chen, 2013). We chose a single-host, single-home study design to eliminate country-level variations affecting our results.

Using a large sample of Japanese MNEs in China with 79,528 subsidiary-year observations, our results show that the crisis triggered more foreign entries in the crisis sector compared to non-crisis sectors, especially in the service segment. At the same time, the crisis also triggered fewer foreign exits, especially in the manufacturing segment. With regard to existing operations, MNEs lowered their equity control to reduce their exposure to risk. Moreover, MNEs of different equity positions (i.e., WOS,
majority, and minority) were under varying levels of partner opportunism and reputational risk. As a result, majority owners were more likely to increase their ownership level to ensure quality control than minority owners. Majority owners were also more likely to disassociate from the reputational risk through divestment, compared with WOS and minority owners.

The present research makes at least three contributions to the literature. First, it contributes to TCE by extending the theoretical argument about the relationship between external uncertainty and organization control. It empirically shows that MNEs are likely to lower their equity control to reduce their exposure to risk in a post-entry crisis setting. Moreover, it introduces the concepts of reputational risk and an MNE’s equity position in examining the relationship between behavioral uncertainty (i.e., partner opportunism) and organizational control. We argue that majority owners, compared with WOS and minority owners, are at high levels of both operational and reputational risk. As a result, they are more likely to increase their equity control or divest. To our knowledge, this is the first study to introduce the concept of an MNE’s equity position in examining behavioral uncertainty.

Second, our study extends Kostova and Zaheer’s (1999) argument that the illegitimacy of local firms provides non-local firms with an initial level of legitimacy in their entry and exit decisions. Integrating the country-of-origin literature, which highlights the trade-offs between symbolic value (Zhou & Hui, 2003) and perceived quality (Knight, Holdsworth, & Mather, 2007) in consumer decisions, we argue and show empirically that MNEs are more likely to enter and less likely to exit in the crisis sector.

Third, we contribute to the crisis management literature (Bondy, Pfarrer, Short, & Coombs, 2016) as applied in international management (Hasse, 2016; Naidoo, 2010; Zhao et al. 2014) by showing that MNEs have a repertoire of strategies to cope with industry-wide crises, including entry, exit, lowering equity control, increasing equity control, and remaining unchanged.
4.2 Research Background

4.2.1 Consumer Confidence Crisis: Food Safety in China

Product-harm crises or well-publicized events involving dangerous or defective products often lead to the loss of consumer trust and damage to product or brand evaluations (Lei, Dawar, & Gurhan-Canli, 2012). In particular, a food safety crisis can go beyond a single product or brand and spill over to the entire food industry. Here, we define “consumer confidence crisis” as a situation where consumers become more concerned about the quality of products, in particular their health, safety and/or environmental features, which reduces their preference for buying the product affected by the crisis. Such a crisis arises from actual or perceived changes in product features that are of concern to consumers.

For example, consumers in North America experienced a major confidence crisis with respect to toys made in China after reports suggested that these products contained high levels of lead. This impacted brands such as Mattel that imported from China, even though the primary cause of the problem was design flaws originating with the U.S. parent firm (Beamish & Bapuji, 2008).

The food sector is particular sensitive to consumer confidence. In China, concerns about domestic food safety standards were elevated in 2008 after the baby milk scandal broke. The melamine-contaminated baby formula scandal was the major event that made Chinese consumers think twice before purchasing domestically produced food products. In a survey conducted by the Chinese government in 2012, 41% of respondents reported that food safety was a “serious problem.” Food safety concerns, inequality, and corruption represented three top governance concerns of the Chinese population (Yasuda, 2015).

Melamine is a nitrogen-rich chemical compound that was used illegally in milk products to create a false appearance of protein content. This food incident led to six infant deaths and 52,000 hospitalizations of young children. A further 250,000 children were estimated to have suffered mild kidney problems due to intake of melamine-contaminated milk products (Wu & Chen, 2013). Moreover, all major producers of milk products were involved in the melamine scandal, including local brands such as Sanlu (a China–New
Zealand joint venture), Mengniu, Yili, and Yashili and foreign brands such as Nestlé and Cadbury (Pei et al., 2011). A survey among Chinese residents in 2011 showed that over 70% of respondents decided not to purchase milk products produced in China. In practice, mainland Chinese flocked to Hong Kong to buy baby formula and other milk products, which created scarcity among Hong Kong residents. In March 2013, the Hong Kong Customs and Excise Department issued a special clause on imports and exports with regard to the quantity of baby formula for those departing from Hong Kong. The limit was 1.8 kg in total weight (2 cans). Otherwise, a person would be liable for a fine of up to HK$500,000 and imprisonment of two years.

In addition to melamine-contaminated milk products, there were also media reports on banned cooking oil (Wu & Chen, 2013), pork contaminated with chemicals, and other unhealthy ingredients in food products. As a result, Chinese consumers purchased food products made in other countries through e-commerce sites such as Taobao.com and JD.com.

4.2.2 Country of Origin and the Food Business

“Country of origin” as a theoretical concept was first demonstrated by an experiment (Schooler & Wildt, 1968) where two products were exactly the same except for the country labels (made in U.S.A. vs. made in Japan). Participants used these country-of-origin labels as cues for the perceived quality in their evaluation, and they favored products made in the United States. Subsequent research has shown that product categories also matter when a country-of-origin effect is present. For example, consumers


22 The exchange rate was C$1 = HK$7.5 in 2013.

preferred cars made in Germany, but preferred shoes from Italy and perfume from France (Roth & Romeo, 1992). Moreover, most studies find home-country biases in product evaluations due to ethnocentrism and national identification, as exemplified by the psychological need for self-enhancement (Verlegh, 2007). Studies among consumers in the Netherlands and the United States showed that both ethnocentrism and national identification positively influenced consumers’ purchasing decisions for domestically produced products over foreign-produced products. This relationship was mediated by the perceived quality of domestic and foreign products.

Country of origin has also been shown to be important in China (Bi et al., 2012). In particular, with regard to products made in developed Western countries, country of origin carries symbolic value as consumers tend to associate Western products with status, modernity, and lifestyle (Zhou & Hui, 2003). A survey among Chinese consumers on inconspicuous consumption of pork sausages made in Canada found that the symbolic value of Canadian food was positively associated with purchasing intention, while the perceived quality and utilitarian value had no impact (Zhou & Hui, 2003).

Why do consumers use country of origin as a cue or signal for perceived quality? There are two mechanisms involved, that is, the halo effect and the summary effect (Knight, Holdsworth, & Mather, 2007). First, the halo effect originates from a vague concept or image of a country that consumers incorporate in their evaluation of products from that country. For example, consumers who imagine New Zealand as having clear skies, clean water, and pleasant pastures might favorably judge New Zealand fruit and believe New Zealand kiwi to compare in quality to Mercedes-Benz cars from Germany (Knight, Holdsworth, & Mather, 2007). Second, the summary effect is a phenomenon in which consumers make judgements about products based on their perception of quality control standards, taste, appearance, and packaging quality. In a qualitative study of professional buyers in the food industry, Knight, Holdsworth, and Mather (2007) found that professional buyers were risk-averse and that their evaluation of the quality of food products was based on their “trust” in the integrity of regulators and suppliers from the country of origin.
We extend these two lines of argument by analyzing the effects of a consumer confidence crisis on enhanced legitimacy for MNEs. A consumer confidence crisis is likely to change consumers’ relative preferences for domestically produced food products over foreign products. We argue that consumers were less likely to be influenced by home-country bias due to their lost trust in the integrity of Chinese regulators and suppliers after the food crisis. First, Chinese consumers had low confidence in Chinese regulators of the food industry. Regulatory interventions by 14 different government agencies created major challenges for effective communication and coordination (Wu & Chen, 2013). Regulatory responsibilities were shared among the Ministry of Health, Ministry of Agriculture, the General Administration of Quality Supervision, Inspection and Quarantine, the Ministry of Commerce, the State Administration for Industry and Commerce, and other agencies involved in food production and storage. Due to the fragmented regulatory authority, there were serious regulatory gaps, conflicting standards, and bureaucratic turf wars among different ministries and all levels of government (Yasuda, 2015). As a result, their supervision of food producers was ineffective (Wu & Chen, 2013).

Second, unlike in Western developed countries, where food production supervision was carried out during the production process, Chinese food was checked only at the final product stage (Pei et al., 2011). As a result, the supervision system was reactive, not proactive. In the case of contaminated milk products, melamine was added to fresh milk when it was collected from individual farmers, who accounted for 80% of the milk supply. The remaining 20% was supplied by self-owned dairy farms of big companies through vertical integration of the supply chain. However, there was no quality check or product control at this stage of production. To make things worse, Sanlu products were exempted from quality checks due to its previous track record of quality, because popular brands in China enjoyed quality-check exemptions (Pei et al., 2011).

Third, in terms of the integrity of producers, there arguably was moral degradation among Chinese producers (Luo, 2008). It has been argued that during the Chinese economy’s transitional period, Chinese producers experienced a state of lawlessness and were profit-driven while engaging in illicit and immoral business practices. Because local
Chinese producers were involved in unethical and immoral behavior in the food industry on such a large scale, the standards in the food industry became problematic.

Chinese consumers tend to differentiate not only between domestic and imported brands, but also to use three categories: domestically made domestic brands, domestically made foreign brands (assumed to have foreign quality control), and imported foreign brands. In terms of consumer ethnocentrism, domestically made domestic products are preferred, ahead of domestically made foreign brands and imported brands (Bi et al., 2012). In terms of quality concerns, however, the preferences are reversed, with imported products being preferred over domestically made foreign brands and local brands (Chang & Park, 2012). We suggest that the consumer confidence crisis resulted in a shift from consumer ethnocentrism to consumer quality concerns, and hence an increased preference for foreign over local products. Below, we analyze how foreign investors responded to such a crisis.

4.3 Hypothesis Development

4.3.1 FDI in Manufacturing and Services

In exploring the responses of foreign investors to a consumer confidence crisis, we are particularly interested in explaining how such responses vary between the manufacturing and service sectors. Previous studies have suggested that firms in the manufacturing and service sectors respond differently to TCE attributes, including environmental uncertainty (Gatignon & Anderson, 1988; Brouthers & Brouthers, 2003).

Manufacturing firms are investment-intensive (i.e., with fixed asset investment upfront, including plant, equipment, and inventory) (Gatignon & Anderson, 1988). On the other hand, service firms are people-intensive (Erramilli & Rao, 1993), and this light-asset feature provides service firms with more flexibility.

4.3.2 Foreign Entry

In general, MNEs are subject to the liability of foreignness (Zaheer, 1995) because the host environment has less information about foreign entrants with which to make informed judgements and actors in the host environments may adopt a different (higher)
legitimacy standard (Kostova & Zaheer, 1999). However, when local firms lose their legitimacy for some reason, non-local firms are perceived as more legitimate (Kostova & Zaheer, 1999). In the crisis industry, local producers have been reported by the media as being involved in unethical behavior. They are perceived by local consumers as illegitimate. As a result, this creates more opportunity for non-local firms in the crisis sector, especially in terms of entry and exit decisions.

If a consumer confidence crisis makes consumers more aware of quality concerns with respect to a particular set of manufacturers or brands, this creates opportunities for those unaffected (or less affected) to gain market share. Specifically, a consumer confidence crisis affecting domestically made products creates opportunities for foreign investors operating in the industry. Foreign entry is more likely in the crisis sector as a consequence of the shift in consumer preferences to foreign and imported brands, which is likely to induce more foreign entries in the crisis sector than in the non-crisis sectors. This leads to our first hypothesis:

**Hypothesis 1a:** The crisis will trigger more foreign entries in the crisis sector.

The strength of this effect is likely to vary between the manufacturing and service sectors. The huge fixed investment upfront poses difficulties for the manufacturing segment to take the opportunity to enter. On the other hand, the light-asset nature of service firms makes it easier for the service segment to exploit the growing opportunity by setting up a business entity.

In addition, given consumers’ differentiation between foreign brands with local production and imported brands, foreign investors will perceive an opportunity specifically in importing rather than local manufacturing. Importers setting up a local operation would register this operation as a service (such as a wholesale operation). Thus, we hypothesize the following:

**Hypothesis 1b:** The crisis will trigger more foreign entries in the service segment of the crisis sector.
4.3.3 Foreign Exit

As argued earlier, a consumer confidence crisis will make consumers more aware of quality concerns with respect to a particular set of manufacturers or brands, especially domestic brands. It therefore creates opportunities for foreign manufacturers and brands. As a result, more market opportunities exist for MNEs, which is likely to induce fewer exits in the crisis sector.

Meanwhile, due to different features of the manufacturing and service segments, they are expected to respond differently. Foreign investors already manufacturing before the crisis need to consider the sunk cost of their existing operations, i.e., fixed upfront investments. They will experience increased opportunities to compete with local firms, provided they can assure consumers that their local manufacturing operations employ quality standards of the parent organization that are higher than those of local firms. Given the sunk cost that these firms face, we expect them to persist in the crisis sector to a greater extent than firms in the manufacturing segment of a non-crisis sector. In service businesses, sunk costs are lower such that we may not see such an effect. Thus, we hypothesize the following:

**Hypothesis 2a:** The crisis will trigger fewer foreign exits in the crisis sector.

**Hypothesis 2b:** The crisis will trigger fewer exits in the manufacturing segment of the crisis sector.

4.3.4 Ownership of Existing Operations

“Organization control” is a central concept in international business research, especially in international joint venture research (e.g., Chen, Paik, & Park, 2010; Yan & Gray, 2001). Yan and Gray (2001) defined organizational control as “the mechanisms a partner employs to ensure that the venture conforms to its interests” (p. 397). In this study, we extend the concept of organizational control to subsidiary control exercised by an MNE.

TCE has been one of the main theoretical lenses to explain organizational control as exercised through equity (Brock, Shenkar, Shoham, & Siscovick, 2008; Delios & Beamish, 1999; Gatignon & Anderson, 1988; Sartor & Beamish, 2014). Traditionally,
TCE has conceptualized control in terms of discrete governance modes, i.e., the make or buy decision (Williamson, 1985). More recently, scholars have argued that firms exercise a wider range of control along the make/buy continuum (Parmigiani, 2007). IJVs represent a hybrid governance structure that lies between wholly owned subsidiary and market transactions (Beamish & Banks, 1987). In IB research, scholars have argued that MNEs exercise greater control over overseas subsidiaries through the retention of equity (Malhotra & Gaur, 2014; Zhao, Luo, & Suh, 2004) and less control when they delegate decision-making power to host-country equity partners (Rangen & Drummond, 2011).

Uncertainty, asset specificity, and transaction frequency constitute the three main attributes of a transaction that increase transaction costs and influence the governance structure of a firm (Williamson, 1985). In this study, organizational control means an MNE’s control over its overseas subsidiaries. Uncertainty refers to the unpredictability of future outcomes (Sartor & Beamish, 2014). Two types of uncertainty exist, i.e., environmental uncertainty and behavioral uncertainty (Crook, Combs, Ketchen, & Aguinis, 2013). Environmental uncertainty refers to “the extent to which a country’s political, legal, cultural, and economic environment threatens the stability of a business operation” (Gatignon & Anderson, 1988: 315). Environmental uncertainty has also been referred to as external uncertainty (Park, Holtbrügge, & Mohr, 2009), economic uncertainty (Brouthers, Brouthers, & Werner, 2003), investment risk (Brouthers, 2002), and country risk (Kim & Hwang, 1992).

Demand uncertainty is one type of environmental uncertainty. Demand uncertainty refers to uncertainty associated with future host-country demand for an MNE’s products (Kim & Hwang, 1992). Whereas demand uncertainty is associated with the external environment over which an MNE has no control, behavioral uncertainty is associated with a transaction partner’s behavior (Griffith, Harmancioglu, & Droge, 2009: 218). Behavioral uncertainty originates from a transaction partner’s opportunistic behavior or opportunism. The following discussion focuses on two research questions: (1a) What is the impact of demand uncertainty on MNEs’ subsidiary control in the crisis sector? (1b) How does the impact vary by industry segments? (2) What is the effect of MNEs’ equity
position (i.e., WOS, majority equity, minority equity) on subsidiary control in the crisis sector?

4.3.4.1 Demand Uncertainty

Extant theory holds that under conditions of environmental uncertainty, including demand uncertainty, firms will prefer hybrids over hierarchies (Sartor & Beamish, 2014). In studying entry-mode choices (i.e., wholly owned subsidiary versus IJV) under the condition of environmental uncertainty, scholars have argued that IJVs are preferred over wholly owned subsidiaries for two reasons. First, IJV partners may possess resources and knowledge to cope with risk (Puck, Holtbrügge, & Mohr, 2008; Beamish & Banks, 1987). Second, IJV partners can share risks when environment uncertainty risk is high and MNEs would prefer to accept a low level of commitment in the host country (Brouthers & Brouthers, 2003). Empirical research has provided consistent support to this line of argument by showing a positive association of environment uncertainty and preference for IJVs over WOSs (Brouthers, 2002; Brouthers, Brouthers, & Werner, 2003; Kim & Hwang, 1992). This result was confirmed in a recent study where there was a negative association between demand uncertainty and organizational control (Sartor & Beamish, 2014). Moreover, the same line of logic was applied in studying post-entry-mode change, where perceived external uncertainty was negatively associated with the likelihood of converting an IJV into a WOS (Puck et al., 2008). In short, when environmental uncertainty is high, MNEs prefer IJVs over WOSs, i.e., take less equity control over the subsidiary, both at the international entry stage and in post-entry-mode conversion.

As argued earlier, when the safety crisis hit the food industry, demand uncertainty was high because of reverse-ethnocentrism and changed consumer behavior. To cope with the risk of an industry-wide crisis, MNEs may assume less organizational control in existing operations, i.e., less equity ownership, to reduce their risk exposure. Hence, we hypothesize the following:
Hypothesis 3a: The crisis will trigger MNEs to take lower equity control in existing operations.

Compared with the people-intensive nature of service firms, manufacturing firms are more investment-intensive, i.e., they have greater investments in plant, equipment, and inventory (Campbell & Verbeke, 1994; Erramilli & Rao, 1993; Gatignon & Anderson, 1988). In entry-mode studies, manufacturing firms prefer IJVs over WOSs due to the flexibility of IJVs. IJVs allow them to reduce their exposure to potential hazards of environmental uncertainty by lowering their resource commitments (Gatignon & Anderson, 1988; Kim & Hwang, 1992; Luo, 2001). This line of argument was supported by several empirical studies (Gatignon & Anderson, 1988; Brouthers & Brouthers, 2003). Environmental uncertainty was found to be significantly related to a preference for IJVs over WOSs for manufacturing firms.

As argued earlier, a domestic consumer confidence crisis can trigger reverse consumer ethnocentrism and increased demand uncertainty for MNEs operating in the food industry. Applying the same line of logic of lowering commitment when environmental uncertainty is high, we argue that manufacturing firms in the crisis sector will take a lower level of equity control so as to lower their potential risk due to demand uncertainty. Hence, we hypothesize the following:

Hypothesis 3b: The crisis will trigger MNEs in the manufacturing segment to take lower equity control in existing operations.

Service firms are more people-intensive and lower in fixed assets. Previous studies suggest that service firms require greater control when there are changes in the environment in order to main flexibility (Bowen & Jones, 1986). When environmental uncertainty increases, IJVs may lack the time to renegotiate contractual agreements, which may reduce the flexibility of MNEs to cope with the changing environment (Erramilli & Rao, 1993). As a result, MNEs may prefer a higher level of control over their subsidiary, i.e., WOSs over IJVs, to maintain flexibility (Hennart, 1994; Williamson, 1991). This line of logic has received mixed empirical support. For example, some studies show that environmental uncertainty is not significantly related to entry-
mode choice in the service segment (Erramilli & Rao, 1993; Brouthers & Brouthers, 2003). However, other studies have found that increased environmental uncertainty is related to the preference for WOSs over IJVs (Contractor & Kundu, 1998).

Applying the logic of increased organizational control in environmental uncertainty in the service sector, we argue that a crisis will trigger MNEs in the service sector to increase their organizational control, i.e., higher levels of equity control, so that they have a higher level of flexibility to cope with the changing environment in a timely manner. Hence, we put forth the following hypothesis:

**Hypothesis 3c:** The crisis will trigger MNEs in the service segment to increase their equity control.

### 4.3.5 Behavioral Uncertainty, Reputational Risk, and Equity Position

First, behavioral uncertainty is “the degree of difficulty in verifying whether compliance with established agreements has occurred” (Geyskens, Steenkamp, & Kumar, 2006). Here, partner opportunism is of particular concern. According to TCE, some economic actors may behave opportunistically and act with self-interest and guile (Williamson, 1985). For an IJV, the local partner’s opportunistic behavior may exert a detrimental effect on the quality of products, although they may claim that these practices lower the cost of the IJV. Compared with IJVs, WOSs are a favorable form of governance structure when partner opportunism is present, as MNEs can exercise fiat over WOSs (Williamson, 1985).

Second, reputation originates from the quality of a product. For a reputation to be widely known beyond its immediate audience, there must be a legitimacy component, i.e., the organization should be regarded as “desirable, proper, and appropriate within a widely shared system of norms and values” (Scott, 1987; cited in Rao, 1994: 30). In other words, to gain favorable social recognition and legitimacy, the behavior or practice of an organization must conform to social norms and expectations (Meyer & Rowan, 1977). Legitimacy acts as a necessary condition for the positive reputation of an organization. It has less to do with the actual quality of a product, and more to do with organizational
practices, i.e., the operational process and standards of making a product must conform to social rules and norms in the first place. If an organization violates norms or social expectations in the operational process of making a product or delivering a service, the organization will gain a bad reputation, which will exert a detrimental impact on its performance outcome. Previous research showed that childcare facilities with institutional linkages had a better survival rate compared with their counterparts with no institutional linkages because they were perceived as more legitimate (Baum & Oliver, 1991).

In the case of MNEs and their overseas subsidiaries, due to negative legitimacy spillover (Kostova & Zaheer, 1999), the illegitimacy of a subunit will hurt the legitimacy of other subunits and the parent firm. In essence, the bad reputation of an overseas subsidiary will hurt the reputation of an MNE as a whole. For example, when a subsidiary of Nike in Southeast Asia experienced problems with its labor practices, the legitimacy of Nike as an organization was called into question (Kostova & Zaheer, 1999).

In the following discussion, we will simultaneously consider the joint impact of behavioral uncertainty (i.e., partner opportunism or operational risk), reputational risk, and equity position (WOS, majority equity, and minority equity) on an MNE’s strategic decision about a focal subsidiary.
Figure 17: Exposure to Operational and Reputational Risk

We define “operational risk” as the risk that an employee within the organization is engaged in bad practices. It is often associated with limited operational control of the organization. Reputation risk refers to the negative legitimacy spillover when the bad reputation of a subsidiary impacts the reputation of the MNE as a whole. In practice, when an MNE adopts a WOS or majority equity position in a subsidiary, the subsidiary will use the brand of the MNE. However, if an MNE adopts a minority position in a subsidiary, the subsidiary is more likely to use the brand of a local partner. As shown in Figure 17, both majority and minority equity owners face a higher operational risk than a WOS owner due to the potential risk of partner opportunism. Meanwhile, both WOSs and majority-owned subsidiaries face a higher reputational risk than minority-owned subsidiaries due to negative legitimacy spillovers. As shown in Figure 17, majority owners are simultaneously exposed to high levels of operational and reputational risk and are the most troubled group compared with minority and WOS owners.

Previous research has shown that MNEs choose WOSs or markets over IJVs in the case of increased behavioral uncertainty (Geyskens et al., 2016) because changing IJV contracts requires mutual consent, which requires time to build (Williamson, 1991). Following the same logic, we argue that, simultaneously challenged by high operational
risk and reputational risk, majority owners may reduce their exposure to risk in two alternative ways: (1) they may increase their operational control or (2) they may disassociate themselves via divestment. The first risk-mitigation strategy is to ensure that high operational standards are maintained in their organizations. This requires higher levels of equity control or even full equity control. To ensure better quality control, majority owners are likely to turn to formal control mechanisms, i.e., equity control, to have a stronger voice in the board of directors over the strategic decision making and day-to-day operations of the focal subsidiary. Hence, we advance the following hypothesis:

**Hypothesis 4a**: Compared with minority owners, majority owners are more likely to increase their equity control in the crisis sector.

The second strategy is to dissociate through divestment, i.e., to eliminate the potential for internal negative legitimacy spillover. Because the illegitimacy of a subunit will exert a negative impact on the legitimacy of the MNE as an organization and other subunits, and given the demand uncertainty in the crisis industry and difficulty in ensuring high operational standards, divestment may not be a bad choice. Hence, we hypothesize the following:

**Hypothesis 4b**: Compared with minority owners, majority owners are more likely to divest in the crisis sector.

**Hypothesis 4c**: Compared with WOS owners, majority owners are more likely to divest in the crisis sector.

### 4.4 Method

#### 4.4.1 Sample and Data Collection

We used the Toyo Keizai dataset, which covers Japanese overseas investment from 1991 to 2017. This dataset covers 40% of all Japanese FDI (Delios & Ensign, 2000). Our sample is restricted to Japanese subsidiaries in China, as China is the empirical setting for the research question. This single-home, single-host study design allows for control over
country-specific effects on the outcome variable. For hypotheses 1 to 3, we use the whole sample and apply a difference-in-difference methodology (Angrist & Pischke, 2008) that allows us to estimate the effects in the focal industry relative to a benchmark of similar firms in other industries.

For hypothesis 4, we are interested in treatment heterogeneity, i.e., how different subgroups in the treatment group respond differently to the treatment (the consumer confidence crisis in the food industry). Following Chung et al. (2013), we limit our analysis to Japanese investment in the Chinese food industry between 2007 and 2017. The reason is that the food safety crisis started in 2008 and there were multiple food scandals over the next few years. In October 2015, a new food safety law was put into practice. Moreover, to ensure that the strategic response of subsidiaries could be attributed to a single parent firm, we selected subsidiaries with only one Japanese parent (Dai, Eden, & Beamish, 2013). The final sample consists of 263 Japanese subsidiaries in the food industry. We created a cross-sectional database of 263 observations to test hypothesis 4.

4.4.2 Measures

Dependent variables. There are four dependent variables in the four hypotheses. For hypothesis 1a/b, the dependent variable is new entry (entry is coded as 1 and 0 otherwise). For hypothesis 2a/b, the dependent variable is exit (exit is coded as 1 and 0 otherwise). For hypothesis 3a/b/c, the dependent variable is equity control and is operationalized as the focal MNE’s ownership level in a subsidiary (Sartor & Beamish, 2014).

For hypothesis 4a/b/c, the dependent variable is a categorical variable of ownership change in a subsidiary, which is defined as the focal Japanese parent’s ownership-level change between 2007 and 2017. This variable has four categories: (1) increase; (2)

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24 Those subsidiaries established in 2017 were excluded from our analysis because ownership-level change could not be measured with the one-year data available.
decrease; (3) unchanged; and (4) divestment. Divestment includes both the closure and selling off of a subsidiary by the MNE (Chung et al., 2013).

**Independent variables.** For hypotheses 1 to 3, the crisis industry is operationalized as the food industry. It is coded as 1 if a subsidiary is in the food industry and 0 otherwise. For hypothesis 4, an MNE’s equity position in a subsidiary is measured by the focal Japanese parent firm’s ownership level in the subsidiary and is converted into four categories: (1) wholly owned subsidiary (ownership level = 100%); (2) majority-owned subsidiary (50% < ownership level < 100%); (3) equity-owned subsidiary (ownership level = 50%); and (4) minority-owned subsidiary (0% < ownership level < 50%).

Regarding the subsidiary’s industry segment, we used the original industry coding of the TK dataset. There are three segments in an industry: (1) manufacturing; (2) wholesale; and (3) retail. Service was operationalized by both wholesale and retail.

**Treatment effect.** To identify the treatment effect, we ran a document count from Factiva with the keywords “food safety” and “China.” The result is shown in Figure 18. The number of articles on Chinese food safety issues gradually increased after 2000 and there was an obvious spike in 2008. We also performed a sensitivity analysis by dividing the number of articles on “food safety in China” by the number of articles on “China” to counter the argument that there have merely been more articles in Factiva over the years. The result also shows that there was a spike in 2008. In the analysis, we use post-2008 as the treatment period.
**Controls.** We also included controls in our analysis. Regarding hypotheses 1 to 3, we included MNEs’ experience in China. This represents MNEs’ local embeddedness, which may provide a valuable knowledge base (Delios & Beamish, 1999; Li & Meyer, 2007) for an MNE to respond to an industry-wide crisis, especially in terms of entry and exit decisions. Meanwhile, the literature on the effect of experience in a host country on the ownership level is inconclusive (Delios & Beamish, 1999; Li & Meyer, 2009). On the one hand, with more experience in the host country, MNEs gain capabilities to operate there. As a result, there is less need to share ownership with local partners and MNEs tend to increase their ownership level as they accumulate more experience (Delios & Beamish, 1999). On the other hand, MNEs may develop the ability to select the right partner over time, which reduces their uncertainty and ownership level (Li & Meyer, 2009). In our study, experience is measured as subsidiary-years by an MNE in China (Delios & Beamish, 2001). Due to its skewness, we used the log transformation of
subsidiary years in the analysis. Moreover, we controlled for the alternative explanation that Chinese consumers turn to foreign-produced food products due to their rising income. The rationale is that foreign food products are more affordable because the Chinese have more disposable income. We included year-fixed effects in the analysis to control for this effect. In addition, we utilized the panel structure of the dataset and estimated all the models using clustered standard errors to account for within-firm correlations.

Regarding hypothesis 4, we controlled for MNE-level and subsidiary-level effects. First, we considered an MNE’s experience in China. Second, at the subsidiary level, we controlled for subsidiary size, as it represents a parent firm’s resource commitment (Delios & Beamish, 1999; Zhang & Beamish, 2017). It was measured by the log transformation of the number of employees.25

4.4.3 Analytical Strategy

For the first three hypotheses, we have three dependent variables, i.e., entry (logistic regression), exit (Cox proportional hazards model), and ownership level of the subsidiary (OLS regression). The main econometrics method is difference in difference (DD) (Angrist & Pischke, 2008), which can take care of both the time trend and the treatment effect. The treatment group is the food industry and the treatment period is post-2008. We also investigated the sub-group differences (i.e., food manufacturing, food wholesale, and food retail) in the food industry.

The main model is specified as follows:

\[ Y_{it} = \alpha + \beta_{\text{FoodIndustry}_i} + \gamma_{\text{Period}_t} + \delta_{\text{FoodIndustry}_i \times \text{Period}_t} + \lambda X_{it} + \varepsilon_{it} \]  (1)

where \( Y_{it} \) is entry in FoodIndustry \( i \) during period \( t \) in hypothesis 1, and exit in FoodIndustry \( i \) during period \( t \) in hypothesis 2. \( Y_{it} \) is the percentage ownership of the

25 Due to missing information on the number of subsidiary employees, the final sample consists of 202 observations.
Japanese MNE in FoodIndustry i during period t in hypothesis 3. FoodIndustry takes the value of 1 if it is in the food industry and 0 otherwise. We have one treatment period in our analysis, which takes the value of 1 if it is post-2008 and 0 otherwise. The coefficient of interest is $\delta$. $X_t$ is a vector of control variables, including year-fixed effects and other control variables.

For illustration purposes, we plotted the DD trend of ownership level for food versus non-food industry (see Figure 19) before our statistical analysis. As shown in Figure 19, the general trend before 2008 was almost parallel between the food industry and non-food industry. We also plotted the trend for sub-groups, i.e., manufacturing segment (Figure 20), wholesale segment (Figure 21), and retail segment (Figure 22).

For hypothesis 4, we used multinomial logistic regression to investigate the effect of an MNE’s equity position and the subsidiary’s industry segment on the MNE’s ownership-level change in a subsidiary. The principal advantage of multinomial logistic regression is that there is no inherent ranking order among the four types of ownership-level change.
Figure 2: DD Trend for Ownership Level: Food Industry versus Non-Food Industry

Figure 20: DD Trend for Ownership Level: Food Manufacturing versus Non-Food Manufacturing
Figure 31: DD Trend for Ownership Level: Food Wholesale versus Non-Food Wholesale

Figure 42: DD Trend for Ownership Level: Food Service versus Non-Food Retail
4.5 Results

4.5.1 Entry

With regard to entry, we used logistic regression to test the odds of entry. The coefficient for the interaction term is of interest. Results in Table 19 show that there is a higher likelihood of entry for the food industry, as the coefficient for the interaction term is 0.21 and the standard error is 0.1, which is significant at a 0.05 level. Among subgroups, the food wholesale sector also shows a higher likelihood of entry, as the coefficient for the interaction term is 0.44 and the standard error is 0.26, which is significant at a 0.1 level. There is no significant result for food manufacturing or food retail. Hypotheses 1a and 1b are supported.

Table 19: Logistic Regression Result for Entry

<table>
<thead>
<tr>
<th>Model</th>
<th>Whole sample</th>
<th>Manufacturing Sector</th>
<th>Wholesale Sector</th>
<th>Retail Sector</th>
</tr>
</thead>
<tbody>
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<td>entry</td>
<td>entry</td>
</tr>
<tr>
<td>Food industry</td>
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<td>0.02</td>
<td>0.08</td>
<td>-0.46***</td>
</tr>
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<td>(0.06)</td>
<td>(0.20)</td>
<td>(0.17)</td>
</tr>
<tr>
<td>Treatment period</td>
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<td>-1.03***</td>
<td>-1.07***</td>
<td>-0.70***</td>
</tr>
<tr>
<td></td>
<td>(0.03)</td>
<td>(0.03)</td>
<td>(0.05)</td>
<td>(0.15)</td>
</tr>
<tr>
<td>Food industry* treatment period</td>
<td><strong>0.21</strong></td>
<td>-0.04</td>
<td><strong>0.44</strong></td>
<td>0.38</td>
</tr>
<tr>
<td></td>
<td>(0.10)</td>
<td>(0.13)</td>
<td>(0.26)</td>
<td>(0.28)</td>
</tr>
<tr>
<td>Constant</td>
<td>-1.73***</td>
<td>-1.82***</td>
<td>-1.38***</td>
<td>-1.12***</td>
</tr>
<tr>
<td></td>
<td>(0.02)</td>
<td>(0.02)</td>
<td>(0.03)</td>
<td>(0.10)</td>
</tr>
<tr>
<td>Observations</td>
<td>79,528</td>
<td>61,169</td>
<td>16,561</td>
<td>1,798</td>
</tr>
</tbody>
</table>

Note: Control variables include MNE experience and year-fixed effects, standard errors in parentheses, *** p<0.01, ** p<0.05, *p<0.1

4.5.2 Exit

We used the Cox proportional hazards model to test subsidiary exit. The result is shown in Table 20. The coefficient of the interaction term is negative and significant for both the food industry (the coefficient is −0.61, the standard error is 0.09, and it is significant at a 0.01 level) and food manufacturing (the coefficient is −0.62, the standard error is 0.11,
and it is significant at a 0.01 level), which means that the crisis triggered fewer exits in the food industry, especially in food manufacturing. Hypotheses 2a and 2b are supported.

**Table 20: Cox Model for Exit**

<table>
<thead>
<tr>
<th>Independent variables</th>
<th>Model 1</th>
<th>Model 2</th>
<th>Model 3</th>
<th>Model 4</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Whole sample</td>
<td>Manufacturing Sector</td>
<td>Wholesale Sector</td>
<td>Retail Sector</td>
</tr>
<tr>
<td>Food industry</td>
<td>0.70***</td>
<td>0.62***</td>
<td>0.64**</td>
<td>0.26</td>
</tr>
<tr>
<td></td>
<td>(0.08)</td>
<td>(0.09)</td>
<td>(0.31)</td>
<td>(0.21)</td>
</tr>
<tr>
<td>Treatment period</td>
<td>0.52***</td>
<td>0.44***</td>
<td>0.48***</td>
<td>0.35*</td>
</tr>
<tr>
<td></td>
<td>(0.03)</td>
<td>(0.04)</td>
<td>(0.08)</td>
<td>(0.18)</td>
</tr>
<tr>
<td>Food industry*</td>
<td>-0.61***</td>
<td>-0.62***</td>
<td>-0.17</td>
<td>-0.20</td>
</tr>
<tr>
<td>treatment period</td>
<td>(0.09)</td>
<td>(0.11)</td>
<td>(0.33)</td>
<td>(0.27)</td>
</tr>
<tr>
<td>Observations</td>
<td>79,528</td>
<td>61,169</td>
<td>16,561</td>
<td>1,798</td>
</tr>
</tbody>
</table>

*Note: Control variables include MNE experience and year-fixed effects, standard errors in parentheses, *** p<0.01, ** p<0.05, * p<0.1*

**4.5.3 Results for Existing Operations**

Table 21 presents the results of the DD analysis. Coefficient estimates and robust standard errors are shown in the table. In hypothesis 3, we hypothesized that MNEs will exercise less organizational control, i.e., less equity, in order to reduce their exposure to risk. Model 1 shows that $\delta$ is $-3.26$, and the standard error is 1.92, which is significant at a 0.05 level. This means that the crisis triggered Japanese MNEs to lower their ownership by 3.26%. Thus, hypothesis 3a is supported.

Models 2, 3, and 4 show the result of sub-group analysis for MNEs in the manufacturing, wholesale, and retail sectors. Consistent with the DD trend, $\delta$ is $-3.84$ for the manufacturing sector, the standard error is 2.12, and it is significant at a 0.1 level. This means that the crisis triggered MNEs in the food manufacturing sector to lower their ownership level by 3.84%. As such, hypothesis 3b is supported. For the service sectors

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26 In a separate analysis when WOSs are excluded from the analysis, the coefficient of the interaction term is 0.02 and it is also significant at the 0.05 level.
(wholesale and retail), neither δs is significant. This means that the crisis did not trigger MNEs in the service sector to change their ownership level. Ergo, hypothesis 3c is not supported.

Table 21: OLS Results for Ownership Level

<table>
<thead>
<tr>
<th>Independent variables</th>
<th>Model 1 Whole sample</th>
<th>Model 2 Manufacturing Sector</th>
<th>Model 3 Wholesale Sector</th>
<th>Model 4 Retail Sector</th>
</tr>
</thead>
<tbody>
<tr>
<td>Food industry</td>
<td>2.44</td>
<td>8.76**</td>
<td>-0.23</td>
<td>2.98</td>
</tr>
<tr>
<td></td>
<td>(-5.25)</td>
<td>(-3.84)</td>
<td>(-3.02)</td>
<td>(-2.82)</td>
</tr>
<tr>
<td>Treatment period</td>
<td>14.69***</td>
<td>16.64***</td>
<td>-5.38</td>
<td>19.40**</td>
</tr>
<tr>
<td></td>
<td>(-2.36)</td>
<td>(-2.57)</td>
<td>(-9.47)</td>
<td>(-8.88)</td>
</tr>
<tr>
<td>Food industry* treatment period</td>
<td>-3.26*</td>
<td>-3.84*</td>
<td>5.86</td>
<td>-1.12</td>
</tr>
<tr>
<td></td>
<td>(-1.92)</td>
<td>(-2.12)</td>
<td>(-6.95)</td>
<td>(-5.41)</td>
</tr>
<tr>
<td>Constant</td>
<td>51.71***</td>
<td>48.90***</td>
<td>70.61***</td>
<td>41.25***</td>
</tr>
<tr>
<td></td>
<td>(-1.57)</td>
<td>(-1.66)</td>
<td>(-7.9)</td>
<td>(-4.06)</td>
</tr>
<tr>
<td>Observations</td>
<td>79,522</td>
<td>61,163</td>
<td>16,561</td>
<td>1,798</td>
</tr>
</tbody>
</table>

Note: Control variables include MNE experience and year-fixed effects, standard errors in parentheses. *** p<0.01, ** p<0.05, * p<0.1

4.5.4 Equity Position and Ownership-Level Change

4.5.4.1 Results of Cross-Tabulation

Table 22 presents the cross-tabulation of MNEs’ ownership status and MNEs’ ownership-level change in subsidiaries. As explained in Section 4.4.1 (Sample and Data Collection), we limited our analysis to Japanese investment in the Chinese food industry between 2007 and 2017. We used a cross-sectional dataset with 263 observations. Overall, 42% of MNEs maintained their original ownership level, while another 43% of MNEs exited the Chinese market altogether. Only 7.6% increased their ownership level, while another 7.6% decreased their ownership level. When an MNE’s ownership status was considered, there were four preliminary results: (1) greater proportions of MNEs as majority shareholders increased their ownership level; (2) greater proportions of MNEs

27 This exit rate of 43% is based upon the cross-sectional dataset, which is different from the annual exit rate (5%) of the entire TK dataset.
as minority shareholders decreased their ownership level; (3) greater proportions of MNEs as WOS owners maintained their current ownership level; and (4) MNEs as WOS owners were much less likely to exit compared with the other three categories.

Table 22: Distribution of MNE’s ownership level change, by MNE’s ownership status

<table>
<thead>
<tr>
<th>Type of ownership status</th>
<th>Type of ownership level change</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Increase</td>
<td>Decrease</td>
</tr>
<tr>
<td>All</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>20</td>
<td>20</td>
</tr>
<tr>
<td></td>
<td>7.60%</td>
<td>7.60%</td>
</tr>
<tr>
<td>WOS</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Not applicable</td>
<td>7</td>
</tr>
<tr>
<td></td>
<td>5.69%</td>
<td>60.16%</td>
</tr>
<tr>
<td>Majority</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>11</td>
<td>3</td>
</tr>
<tr>
<td></td>
<td>20%</td>
<td>5.45%</td>
</tr>
<tr>
<td>Equity</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>0</td>
<td>1</td>
</tr>
<tr>
<td></td>
<td>0%</td>
<td>7.14%</td>
</tr>
<tr>
<td>Minority</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>9</td>
<td>9</td>
</tr>
<tr>
<td></td>
<td>12.68%</td>
<td>12.68%</td>
</tr>
</tbody>
</table>

4.5.4.2 Results of Multinomial Logistic Regression

In Tables 23 to 24, we report the relative risk ratios, which represent the exponential values of the coefficients, and the standard errors. The reference group is no change, with the relative risk ratio representing the relative risk of increase rather than no change, or the relative risk of decrease rather than no change, or the relative risk of exit rather than no change. MNEs’ ownership status, subsidiaries’ industry segment, MNEs’ experience, and subsidiary size all lagged for one year.

Table 23 shows the results of the relative risk ratios when minority was used as the reference group. First, majority shareholders were 3.8 times (the standard error is 2.9 and it is significant at a 0.1 level) more likely to increase their ownership level than minority shareholders, in line with hypothesis 4a. Second, IJVs with a foreign majority shareholder were 3 times (the standard error is 1.8, and it is significant at a 0.1 level)
more likely to exit than those with a minority foreign shareholder, as suggested in hypothesis 4b.

Table 24 shows the result of the relative risk ratios when WOS was used as a reference category. It shows that majority IJV owners were 5.5 times (the standard error is 2.7, and it is significant at a 0.01 level) more likely to exit than investors operating a WOS. This is in line with hypothesis 4c.

Table 23: Relative risk ratios from multinomial logistic regression of type of MNE’s ownership level change (minority shareholder used as the reference category)

<table>
<thead>
<tr>
<th>Characteristics</th>
<th>Increase vs. no change</th>
<th>Decrease vs. no change</th>
<th>Exit vs. no change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ownership type</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Minority (ref)</td>
<td>1</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>WOS</td>
<td>5.18E-08</td>
<td>0.407</td>
<td>0.544</td>
</tr>
<tr>
<td></td>
<td>(3.64E-05)</td>
<td>(0.304)</td>
<td>(0.254)</td>
</tr>
<tr>
<td>Majority</td>
<td>3.865*</td>
<td>1.82</td>
<td>2.999*</td>
</tr>
<tr>
<td></td>
<td>(2.968)</td>
<td>(1.677)</td>
<td>(1.809)</td>
</tr>
<tr>
<td>Equity</td>
<td>9.39E-08</td>
<td>0.692</td>
<td>0.992</td>
</tr>
<tr>
<td></td>
<td>(0.000234)</td>
<td>(0.891)</td>
<td>(0.75)</td>
</tr>
<tr>
<td></td>
<td>(0.219)</td>
<td>(0.175)</td>
<td>(0.123)</td>
</tr>
<tr>
<td>Observations</td>
<td>202</td>
<td>202</td>
<td>202</td>
</tr>
</tbody>
</table>

Note: Control variables include MNE experience, industry segments and subsidiary size, standard errors in parentheses. *** p<0.01, ** p<0.05, * p<0.1.
Table 24: Relative risk ratios from multinomial logistic regression of type of MNE’s ownership level change (WOS used as the reference category)

<table>
<thead>
<tr>
<th>Characteristics</th>
<th>Decrease vs. no change</th>
<th>Exit vs. no change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ownership type</td>
<td></td>
<td></td>
</tr>
<tr>
<td>WOS (ref)</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>Majority</td>
<td>4.474* (3.719)</td>
<td>5.510*** (2.756)</td>
</tr>
<tr>
<td>Equity</td>
<td>1.7 (2.154)</td>
<td>1.822 (1.277)</td>
</tr>
<tr>
<td>Minority</td>
<td>2.458 (1.839)</td>
<td>1.837 (0.857)</td>
</tr>
<tr>
<td>Observations</td>
<td>202</td>
<td>202</td>
</tr>
</tbody>
</table>

Note: Control variables include MNE experience, industry segments and subsidiary size, standard errors in parentheses, *** p<0.01, ** p<0.05, * p<0.1.

4.6 Discussion

The present research is motivated by the question of whether and how a consumer confidence crisis creates opportunities for foreign investors. Our results show that the crisis triggered more foreign entries in the crisis sector, especially in the service segment. Meanwhile, the crisis also triggered fewer foreign exits, especially in the manufacturing segment. With regard to existing operations, MNEs lowered their equity control to reduce their exposure to risk. Moreover, MNEs of different equity positions (i.e., WOS, majority, and minority) were under varying levels of partner opportunism and reputational risk. As a result, majority owners were more likely than minority owners to increase their ownership level to ensure quality control. Majority owners were also more likely to disassociate from reputational risk through divestment, compared with WOS and minority owners.

4.6.1 Theoretical Contributions

This study makes at least three contributions to the literature. First, it contributes to TCE and extends the theoretical argument on external uncertainty, especially in regard to demand uncertainty. Consistent with prior research on entry-mode choice (i.e., IJVs or WOSs) (Gatignon & Anderson, 1988; Sartor & Beamish, 2014) and post-entry mode
conversion (i.e., conversion from IJVs to WOSs) (e.g., Puck et al., 2009), our study suggests that MNEs lowered equity control, i.e., took a lower level of commitment, to cope with environmental uncertainty. This finding goes beyond prior research by extending the argument in a post-entry crisis empirical setting.

In addition to extending the argument on the relationship between environmental uncertainty and organizational control, we also examined the relationship between behavioral uncertainty (i.e., partner opportunism) and organizational control by introducing the concept of reputational risk and an MNE’s equity position. Our results show that compared with WOSs and minority owners, majority owners are at high levels of both operational and reputational risk. As a result, majority owners will choose to either a) increase their ownership level to exert more organizational control in order to ensure product quality or b) disassociate themselves from the IJV altogether through divestments in order to avoid reputational damage to their global brand and operation. To our knowledge, this is the first study that investigates the strategic options of MNEs of different equity positions in coping with partner opportunism.

Second, our study extends Kostova and Zaheer’s (1999) argument that the illegitimacy of local firms provides non-local firms with an initial level of legitimacy in entry and exit decisions. Integrating the country-of-origin literature, which highlights the trade-offs between symbolic value (Zhou & Hui, 2003) and perceived quality (Knight, Holdsworth & Mather, 2007) in consumer decisions, we argue and show empirically that MNEs are more likely to enter and less likely to exit a sector experiencing a local crisis.

Third, we contribute to the crisis management literature (Bondy, Pfarrer, Short, & Coombs, 2016) as applied in international management (Hasse, 2016; Naidoo, 2010; Zhao et al., 2014). When facing political risk or an economic crisis, MNEs adopt a “fight” or “flight” attitude. Most literature on crisis management and FDI has focused on the “flight” scenario and has investigated the determinants of survival (e.g., Chung & Beamish, 2005; Chung et al., 2013; Dai, Eden, & Beamish, 2013; Dai, Eden, & Beamish, 2017). There have only been a few examples of how MNEs “fight” or adjust their operations to survive a crisis (e.g., Chung & Beamish, 2008; Chung et al., 2010; Naidoo,
For example, Naidoo (2010) suggested that marketing innovation helped manufacturing firms survive the global financial crisis after 2009. Our research contributes to the second line of literature by demonstrating that MNEs have a repertoire of strategies of entry, exit, lowering or increasing their ownership level, or simply remaining unchanged, which depends on their equity position and industry segment.

4.6.2 Managerial Implications

This study shows that the negative impact of a food crisis actually created opportunities for MNEs due to the assumption that they abided by high health and safety standards. As there are more opportunities in crisis sectors, MNEs can prepare and manage more entries—especially in the service segment, due to its light-asset nature and flexibility. Meanwhile, our study suggests that being a majority owner in a crisis sector is troublesome. Decisions should be made about whether they should exercise more organizational control or simply divest.

Beyond crisis management, this study also has business ethics implications for managers. Meyer and Rowan (1977) proposed that legitimacy contributes to access to resources and firm survival. It is still applicable for firms even today. The consumer confidence crisis faced by all the industry players in the food sector (especially the baby milk sector) reminds all managers to abide by rules and regulations in order to ensure quality control.

4.6.3 Limitations and Directions for Future Research

This study has a few limitations. First, the data is on MNE subsidiaries from a single home country (Japan) in a single host country (China). This controls for country-specific effects in the outcome variables. Future studies can further explore whether there are more market opportunities for MNEs from other countries, including MNEs from advanced economies and emerging economies. As Japanese MNEs had no major food scandal in China, the results are generalizable to MNEs from those countries that had no food scandals, e.g. the Netherlands. However, the results may be less applicable to MNEs from countries that had food scandals in China, e.g. the USA.
Second, due to the small sample size in testing hypothesis 4, we only included a limited set of control variables. Future research should include additional relevant MNE and subsidiary-level control variables to check the robustness of our results, such as expatriate control and the revenue of the subsidiary.

Third, equity control is just one type of organizational control. Future research could be useful based on more in-depth qualitative studies to investigate how MNEs manage their daily operations to ensure quality standards and the likelihood of vertical integration. In addition, other strategies and tactics used by MNEs to disassociate themselves from a consumer confidence crisis should be further explored.
References


Chapter 5

5 Conclusions

This dissertation focused on non-traditional investment motives within foreign direct investment (FDI). The first objective was to reemphasize the “centrality” of investment motives to firm internationalization research. Given the particular interest in non-traditional FDI, it examined the characteristics and performance of non-traditional investment motives, the relationship between small-employment subsidiaries and survival, and MNEs’ responses to an industry-wide consumer confidence crisis.

Most previous studies on investment motives have covered the four major motives, i.e., market seeking, resource seeking, efficiency seeking, and strategic asset seeking (Dunning, 1993; Dunning & Lundan, 2008). However, there are other investment motives in Dunning’s (1993) original typology, such as in the case of escape, passive, and support investments, including management-supportive, trade-supportive, and finance-supportive investments. Although they are important both in a strategic sense and in terms of investment dollars, these non-traditional investment motives have been regarded as secondary and have received much less attention from scholars in subsequent studies (Cuervo-Cazurra & Narula, 2015).

Many existing studies on investment motives have used aggregate-level data as a proxy for non-traditional investment motives. In addition, small-employment subsidiaries have sometimes been excluded from data analysis. This dissertation attempts to address this research gap by comparing the characteristics and performance of subsidiaries that have non-traditional investment motives with standard subsidiaries. It also investigates the relationship between subsidiary size and survival, with a focus on small-employment subsidiaries.

Essay 1 (Chapter 2) emphasizes the centrality of investment motives in international business (IB) studies by proposing a theoretical framework for the antecedents and consequences of investment motives (see Figure 1). It integrates a) the theoretical argument that an MNE’s ownership advantages (O-advantages) interact with the location
advantages (L-advantages) of host and home countries to jointly determine the type of investment motive(s) of an affiliate (Cuervo-Cazurra & Narula, 2015; Narula, 2012; Meyer, Mudambi, & Narula, 2011) and b) a theoretical framework of the effects of investment motives on subsidiary-level characteristics and performance (Benito, 2015). To achieve that goal, four hypotheses were developed.

The data analysis looks at the characteristics and performance of subsidiaries according to different investment purposes (Chakravarty, Hsieh, Schotter, & Beamish, 2017; Makino, Beamish, & Zhao, 2004), with a special emphasis on non-traditional investment motives. Although there exist different classification typologies of investment purposes (e.g., Cuervo-Cazurra, Narula, & Un, 2015; Behrman, 1972; Hollander, 1970; Hymer, 1976; Kacker, 1985; Porter, 1986; Dunning, 1993; Dunning & Lundan, 2008), as a baseline, we adopt the typology proposed by Dunning (1993). In addition to the four main investment motives (Dunning, 1993; Dunning & Lundan, 2008), this essay pays special attention to two other categories of investment purposes: support investments and passive investments. Essay 1 attempts to answer two research questions: (1) What are the determinants of investment motives? (2) How do subsidiaries with different investment purposes differ in their characteristics and performance?

The key characteristics examined in Essay 1 include subsidiary-level characteristics such as the size of the affiliate (measured by the number of local employees), the ownership mode (wholly owned subsidiary, majority-owned subsidiary, equally owned subsidiary, and minority-owned subsidiary), expatriate control (expatriate number, expatriate percentage), and performance (measured by both revenue and subjective evaluation).

Essay 1 provides a nuanced picture of FDI in functions such as “financing and hedging,” “information gathering and royalty revenue,” and “building new business,” which have been neglected in most empirical analyses of investment motives (Cuervo-Cazurra & Narula, 2015). These investment motives are not only important in a strategic sense, but also in investment dollars. FDI with these motives is substantially different from other types of FDI and collectively exemplifies the central theme of this dissertation—that there is huge heterogeneity (Birkinshaw & Hood, 2008) among subsidiaries. Hence, there
is a need to disaggregate data and treat investments with different investment motives separately. We also argue that where data is available, investment motives should be routinely included in an IB analysis looking at foreign investment. Moreover, our results show that there is a huge difference among subcategories of major investment motives. For example, under the big umbrella of “market-seeking” FDI, there are four subcategories: “local market access,” “tax breaks for investment,” “alliances with customers in Japan,” and “building new business.” The latter three subcategories are substantially different from the first subcategory in all four of the characteristics and performance measures tested in the present research. This suggests that future IB studies should consider investment motives at the subcategory level.

Essay 2 (Chapter 3) examines the relationship between subsidiary size and survival. It addresses the following two research questions: (1) What is the main relationship between subsidiary size and survival? (2) How is the main effect moderated by the special roles of small-employment subsidiaries? Examples of such roles include those serving as centers of importance and vertical investment.

The main theoretical/conceptual lenses were the liability of smallness (Aldrich & Auster, 1986) and orchestration theory (Pitelis & Teece, 2018). Using a sample of Japanese overseas FDI, we found that smaller subsidiaries have a higher exit rate than larger ones. Furthermore, we found that the liability of smallness is conditional upon four factors: (1) serving as a center of importance; (2) vertical investment; (3) being in a human-capital-intensive industry; and (4) being located in a developed country.

Following the theme of non-traditional FDI, Essay 3 (Chapter 4) was empirically motivated by a natural experimental setting where there was an industry-wide consumer confidence crisis in the Chinese food industry after the melamine-contaminated baby milk scandal in 2008. It also fills a theoretical gap in crisis management in the IB literature by going beyond the determinants of survival (e.g., Chung & Beamish, 2005; Dai, Eden, & Beamish, 2013, 2017) and examining the repertoire of strategies that MNEs can deploy in a crisis.
It addresses four research questions: (1) Does a crisis trigger more foreign entries in the crisis sector? (2) Does a crisis trigger fewer foreign exits in the crisis sector? (3) What is the impact of demand uncertainty on MNEs’ subsidiary control in the crisis sector? (4) What is the effect of MNEs’ equity position (i.e., WOS, majority equity, minority equity) on subsidiary control in the crisis sector?

The main theoretical lens was transaction cost economics (TCE) (Coase, 1937; Williamson, 1975; Hennart, 1982) and institutional theory (i.e., legitimacy and reputation) (Kostova & Zaheer, 1999; Rao, 1994). A large sample of Japanese MNEs in China with 79,528 subsidiary-year observations was used.

Our results show that reduced confidence in local products triggered more foreign entries in the crisis sector, especially in the service segment. Meanwhile, the crisis also triggered fewer foreign exits, especially in the manufacturing segment. With regard to existing operations, MNEs lowered their equity control to reduce their exposure to risk. Moreover, MNEs of different equity positions (i.e., WOS, majority, and minority) were under varying levels of partner opportunism and reputational risk. As a result, majority owners were more likely to increase their ownership level to ensure quality control than minority owners. Majority owners were also more likely to disassociate from reputational risk through divestment, compared with WOS and minority owners.

5.1 Contributions

This dissertation makes multiple contributions to the literature, which, taken together, collectively challenge existing views of a “typical” subsidiary in a “typical” investment setting.

First, it contributes to Dunning’s (1993) typology on investment motives by establishing a research baseline on the effect of investment motives on the characteristics and performance of subsidiaries, with special attention given to subsidiaries with non-traditional investment motives.

Second, it shows that subsidiaries with non-traditional investment motives are indeed quantitatively different from typical manufacturing facilities (Beamish & Inkpen, 1998).
They represent extreme outliers in our data analysis. As a result, this dissertation urges scholars to disaggregate data and treat investments with different investment motives separately.

Third, this dissertation extends the literature on the liability of smallness (Aldrich & Auster, 1986) and orchestration theory (Pitelis & Teece, 2018). Our results show that small subsidiaries playing the role of center of importance command a higher status in the MNE network, hence their greater resource endowment. As a result, they have a higher survival likelihood compared with their counterparts without such a role. Meanwhile, small subsidiaries with the function of vertical investment are more tightly integrated within the MNE network and less likely to be divested. In addition, being in a human-capital-intensive industry and being located in a developed country also enhance the survival of small-employment subsidiaries.

Fourth, the dissertation contributes to TCE and extends the theoretical argument on external uncertainty, especially demand uncertainty. Consistent with prior research on entry-mode choice (i.e., IJVs or WOSs) (Gatignon & Anderson, 1988; Sartor & Beamish, 2014) and post-entry mode conversion (i.e., conversion from IJVs to WOSs) (e.g. Puck et al., 2009), our study suggests that MNEs lowered equity control, i.e., took a lower level of commitment, to cope with environmental uncertainty. It goes beyond prior research by extending the argument in a post-entry crisis empirical setting.

In addition to extending the argument on the relationship between environmental uncertainty and organizational control, we also examined the relationship between behavioral uncertainty (i.e., partner opportunism) and organizational control by introducing the concepts of reputational risk and an MNE’s equity position. Our results show that compared with WOSs and minority owners, majority owners are at high levels of both operational and reputational risk. As a consequence, majority owners will choose to either a) increase their ownership level to exert more organizational control in order to ensure product quality or b) disassociate themselves from the IJV through divestment in order to avoid reputational damage to their global brand and operations. To our
knowledge, this is the first study that investigates the strategic options of MNEs of different equity positions in coping with partner opportunism.

Fifth, this study extends Kostova and Zaheer’s (1999) argument that the illegitimacy of local firms provides non-local firms with an initial level of legitimacy in entry and exit decisions. Integrating the country-of-origin literature, which highlights the trade-offs between symbolic value (Zhou & Hui, 2003) and perceived quality (Knight, Holdsworth, & Mather, 2007) in consumer decisions, we argue and show empirically that MNEs are more likely to enter and less likely to exit a crisis sector.

Sixth, we contribute to the crisis management literature (Bondy, Pfarrer, Short, & Coombs, 2016) as it relates to international management (Hasse, 2016; Naidoo, 2010; Zhao et al., 2014). When facing political risk or an economic crisis, many MNEs assume a “fight” or “flight” attitude. Most literature on crisis management and foreign direct investment has focused on the “flight” scenario and investigated the determinants of survival (e.g., Chung & Beamish, 2005; Chung et al., 2013; Dai, Eden, & Beamish, 2013; Dai, Eden, & Beamish, 2017). There have been few examples of how MNEs “fight” or tweak their operations to survive a crisis (e.g., Chung & Beamish, 2008; Chung et al., 2010; Naidoo, 2010; Zhao et al., 2014). For example, Naidoo (2010) suggested that marketing innovation helped manufacturing firms survive the global financial crisis after 2009. Our research contributes to the second line of literature by showing that MNEs have a repertoire of strategies of entry, exit, lowering or increasing their ownership level, or simply remaining unchanged, which depends on their equity positions and industry segments.

5.2 Limitations and Directions for Future Research

This dissertation is not without limitations. First, the empirical analysis is based on FDI from a single home country, which may limit the generalizability of the findings. Future work may examine whether the results are generalizable from other host countries, including those from advanced economies and those from emerging economies.
Second, this dissertation proceeds based on the assumption that once an MNE decides to establish a subsidiary based on one single investment motive, other attributes of the investment (such as affiliate size, mode choice, expatriate control) will follow naturally. Yet an MNE may have multiple investment motives in mind for a subsidiary. Also, even if a subsidiary is established with a single motivation, it may develop or be tasked with meeting other purposes later. Thus, future studies can further analyze the evolution of investment purposes.

Third, although this dissertation proposed a theoretical framework with the inclusion of both home- and host-country advantages and how they interact and contribute to firm-specific advantages (FSAs), due to the limitations of a single home country in the database, these hypotheses are not empirically tested. Future research may further explore the abovementioned relationship by using data from multiple home countries.

Fourth, this dissertation shows the vast heterogeneity among subsidiaries by examining subsidiaries with a small size, i.e., fewer than 20 employees. Future studies can further explore the theme of heterogeneity by examining subsidiaries at both ends of the size distribution, i.e., those with zero employees and those with thousands of employees.

Fifth, the three integrated essays are based upon quantitative data analysis using a well-established database. Future research can develop further survey questionnaires to collect more information based on the same population. Meanwhile, qualitative research using field work and interviews can help researchers better understand the mechanisms involved in a practical setting and generate new theoretical insights to guide future research.
References


Curriculum Vitae

EDUCATION
Ph.D., Ivey Business School, Western University (2019)
LLM, East China University of Political Science and Law, Shanghai (2010)
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- Crisis Response by MNEs: The 2008 Consumer Confidence Crisis in China
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Fall 2018 Instructor, Law and the Multinational Firm
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2011-2015 Research Associate, China Europe International Business School
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