Expanding near the home base or venture far? The influence of home country state on the economic distance of foreign direct investments

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A B S T R A C T
The extent of the economic distance between a firm's home origin and its foreign direct investment (FDI) is an important strategic decision for the investing firm. This study fills an important knowledge gap by investigating the home institutional antecedents of FDI economic distance. Drawing insights from comparative institutionalism, we argue that home-country states vary in both their power to coordinate the economy and the external and internal channels through which they exercise that power. These variations have implications on a firm's motivation and capability to escape external dependencies on the home-country state by investing in economically distant foreign locations. Empirically, using a dataset of 891 new international entrants from 2004 to 2011, we found support for our hypotheses that home-country state power is positively associated with FDI economic distance, and that the influence of the home-country state is contingent on the state's governance quality and its ownership in firms.

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1. Introduction

The location choice of foreign direct investment (FDI) is an important strategic decision for multinational enterprises (MNEs), and this issue has attracted continuous scholarly discussion in international business literature (Jain, Kothari, & Kumar, 2016; Kim & Aguiera, 2016). A critical aspect of FDI location choice concerns the economic (dis)similarity between the home country and the chosen foreign location. This home–host economic distance is formally defined as the level of economic development of the host country relative to that of the home country (Ghemawat, 2001). While a high level of economic distance provides MNEs with the benefits of exploiting or exploring competitive advantages (Tsang & Yip, 2007; Xu & Meyer, 2013), it also creates risks for the investing firms due to increasing liabilities of foreignness in an unfamiliar foreign market environment (Zaheer, 2002).

Existing theories of firm internationalization recognize the strategic importance of economic distance in the firm international expansion process (e.g., Ghemawat, 2001; Johanson & Vahlne, 1977; Luo & Shenkar, 2011). Early research suggests that MNEs expand the economic distance of their FDIs as a result of accumulating foreign market knowledge (Johanson & Vahlne, 1977) or as a result of their adjustment to product life cycles (Vernon, 1966). Essentially, firms commit resources to foreign markets as they grow their resource base, especially in the form of experiential knowledge, which allows them to better manage the risks of international expansion and to cope with their liabilities of foreignness. As such, a firm “expands abroad only as fast as its experience and knowledge allow” (Guillén & García-Canal, 2009: 26). In contrast, some scholars argue that not all firms follow the staged pattern of internationalization and the pattern may vary based on the strategic objectives of each firm (Cui, Meyer, & Hu, 2014; Luo & Tung, 2007). For instance, Tsang and Yip (2007) argue that firms that intend to exploit or explore competitive advantages through FDI will prefer high economic distance in order to access complementary competitive resources that are not available in their home country or in other home-like countries, while firms pursuing vertical or horizontal expansion to strengthen their home market base will prefer low economic distance. Therefore, unlike the predictable processes of the staged models (i.e., Johanson & Vahlne, 1977; Vernon, 1966), MNEs seek foreign locations that best serve their diverse profit or growth objectives and provide a good strategic fit, instead of simply pursuing economic distance in a stylized fashion.

Even though the resource base of MNEs and their strategic orientations are necessarily shaped by their home country conditions (Guillén & García-Canal, 2009; Hoskisson, Wright, Filatotchev, & Peng, 2013), neither the staged models nor the strategic fit argument explicitly examine the role of home country environment. In particular, a home institutional environment determines how economic activities are coordinated, and thus how resources are allocated among economic actors, which provides domestic firms with institutionally derived advantages when they compete internationally (Jackson & Deeg, 2008; Martin, 2013). Relatedly,
the strategic orientations of firms are also strongly influenced by the institutional environments from where they originated (Cuervo-Cazurra, 2011; Hitt, 2016; Lu, Liu, Wright, & Filatotchev, 2014; Peng, Wang, & Jiang, 2008). Although scholars have called for more research into the country-of-origin variations that may strongly influence the internationalization strategy of firms (Meyer, Estrin, Bhaumik, & Peng, 2009a), with a few recent exemptions (e.g., Holburn & Zelner, 2010; Luo & Wang, 2012), existing FDI location choice research has predominantly focused on host country environmental characteristics (Goerzen, Asmussen, & Nielsen, 2013; Kim & Aguilera, 2016). This lack of attention to home country hinders understanding of the institutional origin of strategic variations between MNEs. To address this research gap, this study aims to advance the understanding of the determination of FDI economic distance from a home institutional perspective, with a focus on the role of the home-country state.

We draw on comparative institutionalism as our theoretical basis. This stream of research highlights the role of home country political institutions, such as the state, in providing economic inputs, and subsequently in influencing the patterns of the strategic behaviors of firms (Hall & Soskice, 2001; Jackson & Deeg, 2008; Spencer, Murtha, & Lenway, 2005). From this basis, we develop a theoretical framework of home state influence on FDI economic distance. We explicate the effect of the home country’s state power in motivating firms to escape the external resource dependencies on the home state which limit both their resource access and profit potential (Oliver, 1991; Spencer et al., 2005). Specifically, we argue that a high level of state power within the home country incites firms to target economically distant foreign markets in either an upward fashion to explore competitive resources, or in a downward fashion to exploit state-granted resources. We then discuss the boundary conditions of this home state influence on the strategic choices of firms, as the home country state’s governance quality and the focal firm’s state ownership will alter the firm’s motivation as well as its capability to escape its dependencies on the home country state. Specifically, the escape mechanism is strengthened when the home state’s governance quality is high (e.g. a developmental as opposed to a predatory home state) and therefore supportive of domestic firms in their pursuit of international competitiveness, but is weakened when the focal firm lacks strategic and operational autonomy due to ownership ties with the home-country state.

Empirically, this study analyzes a global pool of new international entrants during the period 2004 to 2011, which included 891 firms from 53 countries entering 86 host countries. This empirical design allows us to illustrate that when internationalization stage, timing, and types of home and host countries are controlled, the home country state’s influence substantially explains the variation in the FDI economic distance between firms. Our empirical effort answers the call by international business scholars to isolate country-of-origin effects from the effects of the stages and timing of internationalization, which subsequently enables a deeper understanding of the source of strategic variation in the internationalization of firms (e.g., Delios & Beamish, 2001; Delios & Henisz, 2003).

This study contributes to the literature in two main aspects. First, this study adds novel insights into the FDI location choice literature by addressing how the home-country state influences the choice of economic distance by firms. Second, this study extends the institution-based view by providing support that 1) not only the type of coordination (who coordinates the economy) but also the quality of coordination (how well the economy is coordinated) cause country institutional systems to differ; 2) the state coordinates the country’s economy through both external (country governance) and internal (ownership control) channels.

2. Literature review and theoretical framework

Given our research objective of understanding the determinants of FDI economic distance from a home institutional perspective, we reviewed the literature regarding the institution-based view of business strategy and FDI location choice. From this broad platform, we then adopted two particular focuses. First, we focused on commonalities within the literature, namely the applications of institutional perspective in FDI location choice studies. Second, among the various institutional perspectives, we drew on comparative institutionalism research to shed light on the role of the home country state in influencing the strategic choices of firms.

The general notion that business activities are influenced by the institutional environment in which they are embedded forms the institution-based view of business strategy, and this in turn supplements the resource-based and industry-based views (Peng, Sun, Pinkham, & Chen, 2009). This general notion, however, encompasses a range of different institutional perspectives derived from various theoretical roots, including new institutional economics, sociological institutional theory (or neo-institutional theory), comparative institutionalism, and the co-evolutionary perspective (Hotho & Pedersen, 2012; Meyer & Peng, 2016). Despite their differences in core assumptions, levels of analysis, and theoretical mechanisms, these perspectives, under the collective label of the institution-based view, highlight the roles of institutional elements as important sources of strategic variation between firms, both within and across institutional contexts, and not simply as a background for business operations.

The application of the institution-based view in FDI location choice research has been prevalent. In a recent review, Kim and Aguilera (2016) found that institutions were the most studied theoretical construct in the 137 FDI location choice studies published between 1998 and 2014. In these studies, researchers mostly adopted new institutional economics or sociological institutional theory perspectives. Accordingly, FDI location choice was considered as simply a response to the level of host country institutional development, with the purpose of minimizing transaction costs (Globerman & Shaprio, 2002; Holmes, Miller, Hitt, & Salmador, 2013), or as an outcome of mimicking the behaviors of other firms in order to attain legitimacy in the host country (Belderbos, Olffen, & Zou, 2011; Henisz & Delios, 2001). This host country focus in the extant literature (see Jain et al., 2016) has led researchers to call for more understanding of the country-of-origin variations that strongly influence the internationalization strategies of firms (Meyer et al., 2009a). Therefore, the current application of the institution-based view in FDI location choice needs to be extended to account for home country institutional elements.

The institutional variation within the country of origin of firms and the subsequent strategic implications for firms have been informed by comparative institutionalism research (Hall & Soskice, 2001; Hotho, 2014; Whitley, 1999, 2005). This institutional perspective focuses on the economic coordination mechanisms of countries. In particular, state coordination of the economy reflects the power of, and the methods used by, governments to intervene and coordinate economic activities (Jackson & Deeg, 2008). In contrast to a liberal market economy, in which the market plays a dominant role in coordinating economic behavior while the government exercises limited power and remains at arm’s length, a state-coordinated economy has the government extending its power to strategically coordinate resource allocation and interfirm relationships in the domestic economy (Hall & Soskice, 2001). Such variation in the power of the state to coordinate the economy leads to varying levels of economic inputs and motives for firms to engage in strategic behaviors, such as innovation (Akkermans, Castaldi, & Los, 2009; Hall & Soskice, 2001; Spencer et al., 2005) and international venturing (Lu et al., 2014; Yamakawa, Peng, & Deeds, 2008). We expect that through shaping the resource base and strategic objectives of firms (Gu & Lu, 2011; Tsang & Yip, 2007), home-country state power will also influence the FDI location decisions of firms, reflected in the economic distance of their FIDs. Following the resource dependency logic (Oliver, 1991; Spencer et al., 2005), as a high level of home-country state power limits the profit-seeking and resource access of domestic firms, firms will be motivated to escape their dependency on the
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