Growth Frontiers in International Business

Edited by Kevin Ibeh, Paz Estrella Tolentino, Odile E.M. Janne, Xiaming Liu

The Academy of International Business

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In Memory of Fred Burton

This book is dedicated to the memory of Fred Burton, who sadly passed away during the first quarter of 2016. Fred was a previous Chair and staunch supporter of the Academy of International Business UK Chapter, and his generous service and contributions to the field of international business will ensure that he continues to be treasured in our collective memories.

Foreword

The 43rd Academy of International Business UK and Ireland Chapter (AIB-UKI) Conference was hosted by the Department of Management, Birkbeck, University of London, on 7–9 April 2016, and this volume of the Palgrave AIB Book Series contains a selection of some of the best sessions and papers presented at the Conference.

The theme of the 2016 Conference was "International Business in a multi-speed global economy", and the Conference programme stimulated discussion and furthered debate about the role of international businesses and policies in revitalising the faltering post-crisis multi-speed global economy. Professor Pankaj Ghemawat of New York University and IESE and Robert Whyte of the World Bank Group headlined the Conference's Opening Plenary, while Professor Julian Birkinshaw of the London Business School delivered a keynote at the inaugural Founders' Plenary, a new initiative introduced to honour the Founding/Early Members & Past Chairs of AIB-UKI. The Special Panels also featured acclaimed professors and policy and industry speakers, notably from the European Commission, Commonwealth Commission, House of Lords and Banco Santander.

Closely related to the theme of the Conference, this volume is entitled "Growth Frontiers in International Business". Its 13 chapters are grouped into four parts, specifically Policy Frontiers, Emerging Market Frontiers, Innovative Pathways and Ethical Growth Avenues, each of which showcases important growth domains in contemporary international business.

I hope you find this book to be interesting and useful. I also hope it encourages you to get involved in the work of the Academy of International Business

United Kingdom & Ireland Chapter. The AIB UK & Ireland website (http://www.aib-uki.org/) provides a wide range of information about the Chapter and matters of interest to international business scholars.

Heinz Tüselmann
Chair, Academy of International Business, UK & Ireland Chapter

Acknowledgement

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Introduction: Towards Advancing the Growth of International Businesses and the Global Economy

Kevin Ibeh, Paz Estrella Tolentino, Odile E.M. Janne, and Xiaming Liu

International businesses, as a collective grouping, have been among the stellar performers of the post-crisis global economy. The upward trending world merchandise and commercial services exports, largely stable global foreign direct investment (FDI) flows (UNCTAD 2015) and rising average *transnationality indices* for the top 100 non-financial transnational corporations from developing and transition economies (UNCTAD 2014) all illustrate this golden era of international enterprise. So is the heightened internationalization and entrepreneurship of small- and medium-sized enterprises (SMEs; Coviello 2015; Zander et al. 2015). A number of factors might explain the resilience of this economic sector.

The first is the typically masterful way in which international enterprises leverage knowledge and act upon the divergent growth–opportunity–risk profiles offered by different geographies and sectors. The second is their ever-increasing capacity to deploy firm-specific advantages, including strategic and operational capabilities, to pursue growth opportunities in national, regional and global markets, including emerging frontiers. The third is their effectiveness in managing complex, spatially dispersed and diverse business environments, value-laden networks and innovative hubs via a mixture of collaborative and competitive strategies (Giroud and Mirza 2015; Chen et al. 2012). Other reasons for the robust health of IB firms include the continuing emergence

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of game-changing, globally marketed innovations and brands; expanding digital internationalization and globalization; markedly rising outward FDI from developing economies, which now account for the preponderance of global outward FDI flows (UNCTAD 2015); increasing prevalence of strategic asset-seeking M&As by developing economy multinationals (Mathews 2006; Chimanade and Rabelloti 2015; Yang et al. 2014); and deepening intra-regional expansion of multinationals from developing regions, notably Latin America and Africa (Ibeh 2015; Ramamurti and Singh 2009).

Despite the undoubted contributions of these actors, the global economy has continued to stutter, remaining at best in a multi-speed dial (El-Erian 2014; Reuters 2014). This edited volume, a product of the 43rd AIB-UKI Conference hosted by the Department of Management at Birkbeck, University of London, on 7–9 April 2016, aims principally to capture and document frontier ideas and reflections on avenues and strategies for further advancing the growth of international enterprises and the global economy. The title of this book, *Growth Frontiers in International Business*, reflects the above-stated focus.

The term 'Growth Frontiers' is used here to encompass avenues, pathways and opportunity triggers that offer potential sources of new radical and incremental growth as well as value creation to international businesses and their home and host economies. These sources may be internal[1] or external[2] to the organization, or a mixture of both.[3] The editors of this volume are pleased to have received contributions, from a diverse cast of established and emergent IB scholars, which richly reflect and illustrate the foregoing conceptualization of IB growth frontiers. These contributions are grouped in four parts that focus respectively on policy frontiers, emerging market frontiers, innovation pathways and ethical growth avenues.

The four parts of the book and their constituent chapters are now discussed.

[1] Internal growth frontiers refer to growth avenues emanating from organizational actions, notably strategic initiatives, innovations, resource configurations or structural or cultural transformation that might enable international businesses take better advantage of new market opportunities.

[2] External growth frontiers include newly emerging economies, marketplaces, industries, radical innovations or practices emanating from shifts or trends in the global, regional, technological, institutional or socio-cultural environments, which international businesses might capitalize upon to grow further.

[3] External–internal growth frontiers encompass opportunity platforms arising from organizational responses to initiatives by national, regional, global institutions to address major global challenges, including inter alia advancing human/equal rights and pay equity/fairness, and combatting climate change and corporate abuses.

Part I Policy Frontiers

Part I comprises contributions on growth-enhancing policy or institutional mechanisms that support businesses to more actively pursue international market opportunities or undertake FDI or re-investment. Chapters 2, 3 and 4 make up this section of the book.

Chapter 2 by Mainela, Puhakka and Sipola sets the tone by discussing the confluence of private–public sector interests and institutional infrastructure that underpin and support start-up industries to undertake international high-growth venturing. Drawing on a review of contextual influences on international entrepreneurship, including the social setting in which international entrepreneurial behaviour is embedded, the authors develop a conceptualization of a collective activity-based start-up industry for international high-growth venturing. Subsequent empirical study of Israeli's start-up industry enables the explication of the contextual determinants of international venturing in start-up industries and contributes to the understanding of start-up industries as a particular growth frontier in IB.

Kalinic and Clegg's Chapter 3 picks up the growth narrative, by focusing on one of the most prominent themes within the economic growth agenda of the European Union, specifically the internationalization of SMEs and the role of public policies and allied initiatives in facilitating this. Reflecting the widespread appreciation of SMEs and entrepreneurial firms as quintessential engines of economic growth, at national and international levels, many governments are actively pursuing policies to support the internationalization of their SMEs. Kalinic and Clegg argue that such support measures must, for effectiveness sake, be underpinned by an appropriately identified and 'proven' internationalization theory (or theories). Pertinent theoretical insights should influence how best to tackle firm-level gaps, for example, regarding availability and terms of finance, capacity-building, knowledge acquisition and 'brand' awareness. The chapter underlines the need for all internationalization boosting measures to contribute to the ultimate objective of enhancing the economic growth of focal economies.

Chapter 4 by Kalfadellis and Freeman continues on the theme of support measures, specifically 'after-care' services provided by inward investment promotion agencies (IIPAs) to attract repeat investment by multinational enterprises (MNEs). Such additions to stock of FDI represent an often-ignored, but important growth avenue in IB. These authors argue that IIPAs need to invest effort and resources, typically via 'after-care' service provision, in nurturing and 'looking after' established MNE operations within their sphere of interest, given evidence that these firms are likely to engage in repeat investment or upgrade operations in their existing foreign location(s). Based on their study of the perceptions of foreign MNE subsidiaries in Australia, the authors called on governments and their IIPAs to consider varying 'after-care' service provision according to the size and age of foreign subsidiaries. They further posit that such differentiation of 'after-care' service provision might help to generate growth-boosting repeat investment from larger MNEs as well as SMEs and recently established foreign MNEs.

Emerging Market Frontiers

Part II assembles studies on emerging market firms, arguably the most prominent growth symbols of the past few decades. The three constituent Chapters, 5, 6 and 7, examine the contemporary remarkable growth of international businesses from newly emerging economies, now accounting for the preponderance of global outward FDI flows.

Tang and Pearce's Chapter 5 discusses the pervasive rise of Chinese and other emerging market multinationals (EM-MNEs) associated with spectacular international growth levels. These authors acknowledge that the earlier-than-expected emergence of these firms as MNEs challenges established thinking in IB theorizing, but argue for their accelerated internationalization to be seen as integral to the processes of their home-country development, in ways that were not relevant to the comparable growth of traditional 'Western' MNEs. The chapter, organized around a macro–micro, FSA–CSA framework, suggests that at the macro-home country level, these countries' development not only generates resources (e.g., capital and foreign exchange) that can be leveraged to support FDI, but also creates imbalances (resource shortages and knowledge constraints) that provide motivations for FDI. This, at the micro firm level, places EM-MNEs' growth within the institutions of national development and thereby indicates the need for relationship-building competences to secure this position.

Chapter 6 by Coban explores Business Groups (BGs), another increasingly important, internationally active organizational form originating mainly from emerging economies. The chapter underlines the pivotal role of BGs, especially Turkish BGs, in internationalization activities in emerging economies and examines the factors, including unique home-country environmental characteristics, that influence their emergence and enable them to compete with developed country MNEs.

Chapter 7 by Laine and Kuivalainen examines institutional constraints on the internationalization of new ventures in Russia, based on the premise that re-engineering and upgrading the institutional environment in previous command economies such as Russia might offer an important new frontier for boosting new venture creation and entrepreneurial internationalization. Drawing on interviews with entrepreneurs and government officials, specifically regarding their perceptions and experiences of the impact of Russian institutional environment on entrepreneurial growth and internationalization, the chapter illuminates and discusses critical impediments to the growth and internationalization of new Russian ventures. The authors also offer practical insights on how the internationalization of entrepreneurial ventures might be facilitated through improvements in the institutional environment.

Innovation Pathways: Sectors, Knowledge Flows and Entry Modes

Part III accommodates studies of emergent IB sectors whose relative newness to internationalization opens up spaces for new international market actors and offers additional IB growth opportunities. Also included here are chapters on knowledge flows and entry mode options, which reportedly have positive implications on growth at various levels. Each of the four chapters, 8, 9, 10 and 11, constituting this part of the book is now discussed.

Chapters 8 and 9 focus on a recently emerging internationalization growth pathway, specifically the innovative expansion of socially oriented organizations and arts organizations into international markets. Ritvala, Piekkari, Franck and Granqvist's Chapter 8 draws on a qualitative study of the Guggenheim Foundation to discuss the relatively recent opening of foreign outposts by art museums, largely overlooked in IB research. Contending that museums provide an interesting context to study how institutional complexity shapes internationalization, and using an innovative narrative methodology, the authors found the foundation's internationalization process to be characterized by unpredictability and complex political negotiations. They also found that non-business actors had a powerful voice and that past international market entries and heritage shaped subsequent moves. The next chapter, by Jie, Saarenketo and Puumalainen, adds to the scant knowledge base on internationalization of socially oriented organizations, by exploring three potential determinants, specifically organizational form or relative economic sustainability, social nature or type of interventions undertaken and home country's institutional environment. Based on a data set of 271 socially oriented organizations from 63 countries, these authors found that organizations undertaking social interventions aimed at improving beneficiaries' satisfaction with employment opportunities and employment conditions were less likely to be international than their counterparts that do not undertake such interventions. Socially oriented organizations that conduct social interventions to improve beneficiaries' satisfaction with formal and informal education, natural and communal environment, physical and mental health, or access to physical resources such as clean water, energy and housing were found more likely to be international than those that do not conduct such interventions. The study also found that nonprofit organizations do not differ significantly from social ventures in terms of likelihood of internationalization, and that stronger and better-developed institutions in the home country facilitated the internationalization of socially oriented organizations.

In Chapter 10, Cook, Shevtsova, Lööf and Larijani continue on the innovation theme, by examining the impact of local and global external knowledge on the productivity and innovativeness of MNEs located in various UK regions. This study's focus on productivity, measured as total factor productivity, is critically important as it is a driver of long-run growth, a major focus of this book. The authors distinguish between high-technology and low-technology industries, use the global openness of regional industry and regional economy as proxies for global knowledge flows and assess the effect of access to complex and tacit knowledge on innovation. The study finds, inter alia, that access to knowledge-intensive professional services had a generally positive and significant effect on productivity growth in domestic MNEs, but not on patenting. The effects of openness to trade were also found to be generally positive and sometimes significant for productivity growth.

Chapter 11 by Ahi and Kuivalainen draws on real options reasoning to conceptualize firm entry mode choices as alternative investment opportunities with varying growth implications. As the authors argue, noticing and later exercising shadow options offer potential growth opportunities to firms entering international markets, depending, however, on the firm's attention structure and entrepreneurial orientation. The chapter attributes entrepreneurially orientated firms, with requisite internal capabilities and attention structure, with greater likelihood of noticing and exercising effective shadow options (or selecting more appropriate entry modes), hence achieving international market growth. Two illustrative practice-based examples are used by the authors to further develop the arguments made in the chapter, which ends with a discussion of its contribution to enhancing firm's growth in uncertain global markets.

Ethical Growth Avenues

Part IV accommodates the final two chapters of the book devoted to the ethical underpinnings of growth, specifically the role of democratic values and pay equity in facilitating firm performance and FDI inflow, hence economic growth.

Filippaios, Annan-Diab and Hermidas' Chapter 12 suggests that the deepening of democratic tenets offers an important avenue for promoting inward FDI, job creation and economic growth in host economies. Cognisant of the contrasting previous findings on democracy level-inward FDI relationship the authors introduced a number of conceptual refinements, notably using disaggregated measures of democracy (civil liberties and political rights) and integrating the investing MNEs' motivations and existence of human capital as moderators. Their empirical tests, which drew on vast, longitudinal sample of investment projects in 110 developing and emerging economies, found a non-linear relationship between civil liberties and FDI and a positive moderating effect of human capital on this relationship.

Based on the view of pay equity as a probable 'new frontier' for enhancing firm performance and growth internationally, Chapter 13, by Yu and Luu, examines the relative relevance of equity fairness theory (smaller pay dispersion) and tournament theory (greater pay dispersion) in explaining firm performance and global valuation. Controlling for cultural differences across countries, they found evidence that equity theory prevails in most sub-groups of their sample. The authors, thus, call for greater adoption of pay equity or lower pay dispersion among international corporations given its overall positive impact on corporate performance and growth.

Conclusion

Taken together, this book showcases external (Parts I and II), internal (Part III) and external–internal pathways or frontiers to international growth available to organizations across demographic divides. The overarching message can be summarized as follows. First, effective policy and institutional support measures are still enduring sources and catalysts for growth at multiple levels—micro, macro, local, regional, international and global. Such support measures appear to underpin the high-growth international venturing witnessed among start-up industries and can be similarly influential in boosting internationalization and repeat investment among SMEs and foreign direct investors, respectively. Second, as Part II's focus on Chinese multinationals, Turkish BGs, and Russian entrepreneurial ventures demonstrates, emerging market firms continue to represent an important frontier for growth in IB and the global economy. Upgrading the pervasive institutional voids in their home economies might further help to unleash the growth potentials of IB actors from these economies. Third, the recent but increasing international expansion of art museums, social ventures, not-for-profit organizations and allied socially oriented organizations presents a somewhat innovative growth path for international enterprises. Understanding the levers to be pulled and the conditions that need to exist for this new internationalization corridor to continue sustainably is again critically important. Fourth, access to local and global external knowledge and firm-level entrepreneurial orientation respectively seem to increase the likelihood of productivity growth among MNEs, and of noticing and exercising shadow options (or selecting more appropriate entry or growth modes) among firms entering international markets. Although the role of these capabilities as growth-enhancers in IB is widely known, greater efforts to facilitate their adoption among enterprises of varying demographics would be further helpful. Finally, in the deepening of democratic tenets and greater adoption of pay equity among corporations operating internationally, both ethical and sustainable organizational principles appear to be important pathways for attracting inward FDI and enhancing firm performance, respectively.

The foregoing themes, clearly, do not exhaust the range of actual and potential growth frontiers in IB. The challenge thus remains for IB scholars to identify and crystallize the many other staircases to IB growth and value generation not covered in this book. Questions that might assist this germane research programme include: Which new markets, geographies, industries and network constellations might international businesses further capitalize upon to grow? What strategies might help unleash new market opportunities or resource configurations? How might international businesses enhance their engagement with fast-growing economies? How might they enhance their contributions to addressing some of the world's major growth-constraining challenges, including geo-political tensions? And what further roles could institutions—national, regional, global—play in redressing growth-limiting leakages or corporate abuses?

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Part I

Policy Frontiers

2

Instigating Start-Up Industries as a Foundation for International High-Growth Venturing

Tuija Mainela, Vesa Puhakka, and Sakari Sipola

Introduction

Every national economy needs to raise growing companies, and in particular those growing in global markets. Much of this growth falls on the shoulders of innovative, international new ventures (Autio et al. 2000). The emergence and growth of international ventures have long been explained by entrepreneur- and venture-specific factors (Knight and Cavusgil 2004; McDougall 1989; Oviatt and McDougall 1994). Therefore, explanations for success and failure are often sought from capabilities, orientations, and company strategies. The research suggests, for example, that alertness is a key characteristic, and knowledge and networks are key determinants of international opportunity discovery.

A smaller stream of international entrepreneurship research searches for the determinants of performance of international new ventures from the national contexts of the entrepreneurs and the new ventures (e.g., Baker et al. 2005; Zander 2004). Expanding from this stream, we suggest that the so-called start-up industry, in which the new venture is embedded, is the key to understanding international entrepreneurial outcomes in global markets. A start-up industry consists of private and public actors that are professionally organized around an attempt to foster the emergence of high-growth firms

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for international markets (Eliasson and Eliasson 1996, 2005). Together, their activity creates a basis for and drives the international entrepreneurial venturing. Collective activity in international growth venturing has attracted scant attention in international entrepreneurship research.

With a focus on collective activity, we emphasize the context-embeddedness of international venturing. Although previous research has often dealt with the general environmental, institutional, and cultural characteristics of countries (e.g., Anokhin and Wincent 2012; Tracey and Phillips 2011), deeper analysis of the activity by a collection of actors more or less aligned to create and support high-growth venturing is scarce. The deep contextualization requires attention to history and time in the development of the activity (Welter 2011).

A related consideration is the collectiveness of the activity. Entrepreneurial agency, such as international venturing, is an outcome of a relational process of interactions involving both the social and material elements of the context (Venkataraman et al. 2012; Garud and Giuliani 2013). The actors who become involved each shape the venturing processes by framing a venture perceived as the target. Accordingly, the collectives of actors in start-up industries perceive high-growth ventures as the primary target of their activity, and we search for the context-embedded elements of this perception. This leads us to ask the following question: How does the collective activity for international high-growth venturing evolve in the context of start-up industries?

Our examination starts with a discussion of the context-embedded nature of international opportunity-related processes in international entrepreneurship. We will reflect upon the prior research that has treated the context and has specified its influences on international entrepreneurial activities. We will then present the venture framing by the start-up industry as a construct for understanding the entrepreneurial contexts in relation to international growth venturing. In the empirical part of the study, we analyze the case of Israel in order to examine the evolution of collective activity for high-growth venturing and its relation to the outcomes of a start-up industry.

Although we engage in country-based analysis, we are not interested in the general question of national differences in entrepreneurial activities (where entrepreneurship research has already made significant progress—e.g., Cullen et al. 2014; Levie et al. 2014). In line with our definition of start-up industries, we emphasize high-growth companies, which are often venture capital backed and aim for global market operations as the outcome, as a particularly interesting type of international entrepreneurial venture. This allows us to elaborate the contextual views of international entrepreneurship toward understanding the collective activity influencing the emergence of international new ventures.

Moreover, we contribute to the discussion on international growth as a social process that is aimed at emergence of international high-growth ventures. By elaborating the contextual determinants of international venturing for high-growth, we present start-up industries as a particular growth frontier in international business.

Context-Embeddedness of High-Growth Venturing

Prior research often acknowledges that regions and countries have particular infrastructures, capabilities, and other resources in relation to international venturing (e.g., Di Gregorio et al. 2008; Zander 2004). Furthermore, individuals in different national contexts and in a variety of social situations are likely to be motivated by diverse purposes, and therefore social structures are the key determinants of the character of the perceived opportunities (Baker et al. 2005). This emphasizes the contextualized view of entrepreneurial venturing (Dana 1995; Davidsson et al. 2006; Welter 2011; Wiklund et al. 2011). Hence, international venturing is neither individual nor coincidental; the patterned social circumstances create similarities to entrepreneurial activity (Baker et al. 2005). Toward the end of this section, we connect the patterned social circumstances with the notion of collective activity in high-growth venturing.

Contextuality of International Entrepreneurial Activities

Context-embedded and context-influenced views of entrepreneurial activities are prevalent in international entrepreneurship research. The kind of local setting, in which the entrepreneur is willing to establish a new business, matters, as the context influences the cognitive processes of the entrepreneur (Zander 2004). Cognitions are related to the motivations of entrepreneurs to do international business. It is the motivation and mindset, which rest on cultural values and histories, that determine the entrepreneur's actions with respect to a firm's establishment, the scale and scope of its operations, and its resource allocation (Zahra et al. 2005). International entrepreneurs' opportunity identification is, hence, influenced by cultural values in both home and host countries and by cultural differences (Muzychenko 2008). An approach that connects opportunities with their geographic contexts is, therefore, useful for understanding how entrepreneurs perceive and construct the industries' boundaries and international opportunities, and develop the international venturing strategies thereof (Zahra et al. 2005).

Several empirical studies suggest that firms behave differently on the basis of the home-country characteristics that support different cognitions of international opportunities and perceptions of foreign markets. For example, Liu et al. (2008) propose that the Chinese transition context leads to a bounded entrepreneurial cognition of international opportunities, which in turn leads to gradual internationalization. The limited education and experience and the institutional barriers experienced by Chinese entrepreneurs make the business founders unaware of the possible similarities of foreign markets that allow for international business. Entrepreneurial cognition develops to a large extent on the basis of possibilities for interaction with different people and situations (Andersson and Evers 2015). The research in ethnic contexts has brought up considerations with respect to the embeddedness of business practice within the moral order of a community and the power of cultural symbols in creating unconscious but recurring ways of action that are seen as appropriate in the context (Crick et al. 2001). Mainela and Puhakka (2009) also support this view as they stress the cognitive activities of individuals in interpreting the multicultural environment of the opportunities in a transition market. The social setting is a 'discussion partner' with various points of view to be acknowledged.

Small firms tend to rely on external business services, which emphasize the influence of other home market actors, urbanization, and industrial concentration on the firm's decision-making (Mittelstaedt et al. 2006). Sequeira et al. (2009) show that the transnational entrepreneur's degree of embeddedness in their home country influences the type of firm established as well as determines its success. In an entrepreneur's decision to internationalize, the influence of environment can be experienced either as push or as pull (Dana et al. 2009). The environment thus either forces or attracts efforts to internationalize.

The institutional settings of the home countries have, in particular, been emphasized in the emergence of new business. De Clercq et al. (2010) note the entrepreneurs in emerging economies to be hindered by the underdeveloped institutional structures for business establishment, but see some deficits overcome by networking activity. Nasra and Dacin (2010) stress the active role of governments in creating conditions for business and demonstrate how the state in Dubai has taken action to shape the essential infrastructure for capitalizing on business opportunities. Webb et al. (2010) note the possible active role of multinational companies and non-governmental organizations in changing the host country institutions in order to support new value creation.

Stenholm et al. (2013) take innovative high-impact ventures as a separate type of entrepreneurial activity and test the institutional environment against them. For high-impact ventures, the environment should be characterized by knowledge spillovers creating new opportunities and enough capital. The regulative environment matters very little. This supports our focus on the collective activity in start-up industry context, instead of the general institutional and cultural environments for entrepreneurship.

Consequently, it is not only the entrepreneurs or new ventures that are active in the process of international high-growth venturing but also the system as a whole. In our case, the start-up industry performs a common activity. The activity has such determinants as the social pressures and expected consequences related to certain behaviours, and a resource base and networks on which to rely. Baker et al. (2005) emphasize the division of labour, evaluations of opportunity costs, and resource availability as the determinants of opportunity-focused behaviours, and their dependence on the nation's institutional and economic heritage. We go further from these examinations of the contextual influences on international venturing to delineate a conceptualization of collective activity for high-growth venturing.

Start-Up Industries as Contexts for High-Growth Venturing

The emergence of start-ups that become global winners by achieving leadership positions in international markets is important for economic prosperity. For this purpose, many developed countries have aimed to move from the so-called managed economies, with size and scale economies and routinized production, to the so-called entrepreneurial economies, with institutions aimed at facilitating growth through distributed innovation and new innovative firms (Audretsch and Thurik 2001, 2010). Hence, we can identify national frameworks for the support of what we call start-up industries—also described as entrepreneurial environments (Lerner 2010), start-up communities (Feld 2012), and start-up ecosystems (Mason and Brown 2014).

In defining start-up industry, we rely on the notion that a particular type and a limited number of high-growth firms generate a large share of new net jobs and contribute the most to wealth creation (Acs et al. 2008; Birch and Medoff 1994; Henrekson and Johansson 2010; Shane 2009). These rapid growth 'gazelles' pursue business opportunities that are risky, but have high-reward potential (Birch 1979, 1987). Start-up industry thus refers to the development of high-ambition and high-growth-expectation ventures into gazelles that seek to win in large international markets. The institutions and infrastructure of the start-up industry focus on generating high-growth-potential start-ups and scaling them into market winners—the targeted outcome of their activity. Due to their youth and the risks involved, these new ventures often face funding difficulties, which is why venture capital is considered as a specialized mechanism for financing entries to global markets (Lerner 2010). The entrepreneurs aiming at growth venturing often also aim at an exit; the creation of a new venture or a firm's mere survival is not sufficient (Wennberg and DeTienne 2014). Eventually, exits can trigger a process of the entrepreneurial recycling of financial and knowledge resources in a region (Mason and Harrison 2006), which make them important in fostering economic growth.

The start-up industry provides a particular substantive context for international venturing. It allows emphasis on the context that the actors face—in other words, the 'who', 'what', 'where', and 'when' of the activity—instead of taking the context to be variables (Welter 2011). Accordingly, there is a need to understand the legacy the present-day activity carries from the past and the way venturing evolves over time in relation to the other contextual developments. Furthermore, the context defines the generative forces of action that manifest as particular outcomes for growth venturing (Garud and Giuliani 2013). The collective activity embodies a relational process of distributed efforts in which the involved actors bring to the fore their own views for framing the venture (Garud and Giuliani 2013).

Based on our review of the contextual influences on international entrepreneurship, the start-up industry develops on the basis of patterned social circumstances defined through history and time (see Fig. 2.1). The

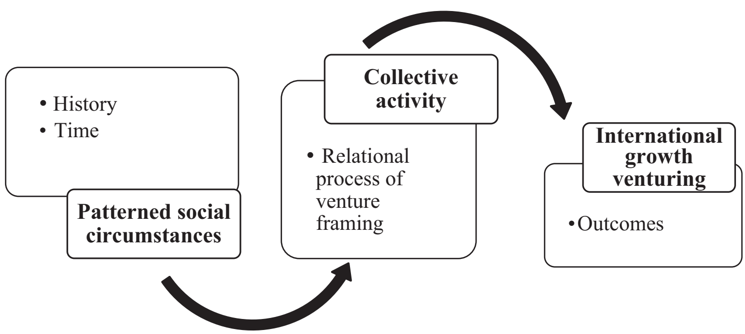

Fig. 2.1 The start-up industry as a context for the collective activity of venture framing

core of the start-up industry is the collective activity actualized in a relational process of venture framing by the entrepreneurs, venture capitalists, and public actors. On this basis, we proceed to examine the developments of the start-up industry of Israel and search for the explanations for its outcomes.

Methodology

Our empirical study involves an examination of growth venturing-related events and perceptions in the Israeli start-up industry. Israel is seen as a start-up nation, and its historical performance in producing internationally successful start-ups is among the best in the world (Senor and Singer 2009). With respect to its potential for entrepreneurship, it ranks among the top 20 nations (Acs et al. 2014) and, as an export-dependent economy with a small domestic market, has almost a necessity to search for growth through internationalization.

Our empirical study started with the collection of extensive documentation with regard to the national developments related to start-ups and growth venturing. The data include reports and statistics from different private and public organizations, such as the venture-capital associations, ministries, and funding agencies. Data such as stock exchange listings and Deloitte's Technology Fast 50/Technology Fast 500 listings of high-growth firms were utilized, as well as research on the innovation and entrepreneurship systems in the country. In addition, videos, presentations, and other online material regarding the economy were collected. The data enabled drawing a picture of the general structure of the start-up industry in terms of the organization of the actors and resources, the key events in the economy, and the performance of the industry over time.

To understand the activity of the start-up industry, a search for the mechanisms explaining the developments was needed (Welch et al. 2011). For this purpose, interview data covering the experiences and views of various actors active in the industry were collected. In total, 19 interviews were conducted during data collection trips in Israel and via Skype (see Table 2.1). The interviewees were selected based on their experience in entrepreneurship, international business building, and knowledge of the developments of the national start-up industry. We interviewed entrepreneurs, venture capitalists, start-up CEOs, university personnel, and public sector actors. The data include an interview with an entrepreneur who listed his venture in NASDAQ and later became a venture capitalist.

Table 2.1 The primary empirical data of the study

Interviews		
Type of interviewee	*Minutes*	*Primary motivation for the interview*
Entrepreneurs (3)	168	Views of the entrepreneurs on the activity
Entrepreneur, venture capitalist (1)	108	View of an entrepreneur and understanding the process of building a NASDAQ-listed start-up
Venture capitalists (7)	385	Views of venture capitalists on the activity
Start-up CEO (1)	99	Views of start-up managers on the activity
University personnel (3)	241	Understanding of university–entrepreneurship relationship
Public sector officials (3)	217	Understanding public structures and support to high-growth entrepreneurship and new ventures
Incubator program director (1)	60	Understanding public structures and support to high-growth entrepreneurship and new ventures
Observations		
Type of event	*Duration*	*Information received*
High Tech Industry Association conference (2)	6 days	Interactions of entrepreneurs, start-ups, business angels, venture capitals, MNCs, and other key stakeholders of the Israeli start-up industry

The exact focuses of the interviews varied on the basis of the actor type and the interviewees' experience, but all interviews covered interviewee's views on high-growth entrepreneurship, start-up activity and support, entrepreneurial finance, and goals and success as interpreted in the organization in question. All the interviews were recorded and then transcribed verbatim. The recordings amount to 1278 minutes altogether, resulting in an average of 67 minutes for each interview. The data also include six days of observations in start-up-related events (see Table 2.1). Notes were taken during the interviews and observations, and first reflections were recorded, both in writing and in voice memos.

The key findings from the first round of analysis, which focused on the secondary data, were concretized as a timeline of the events related to the development of the start-up industry over five decades (see Fig. 2.2). The second round of analysis involved in-depth examination of the interview transcripts. Some key insights started to emerge while the data collection still continued. This interwoven data collection and analysis enabled the theory to develop alongside the growing volume of data (Miles and Huberman 1994). The notes, memos, and diagrams made during and immediately after the interviews were the beginning of the data analysis that then progressed

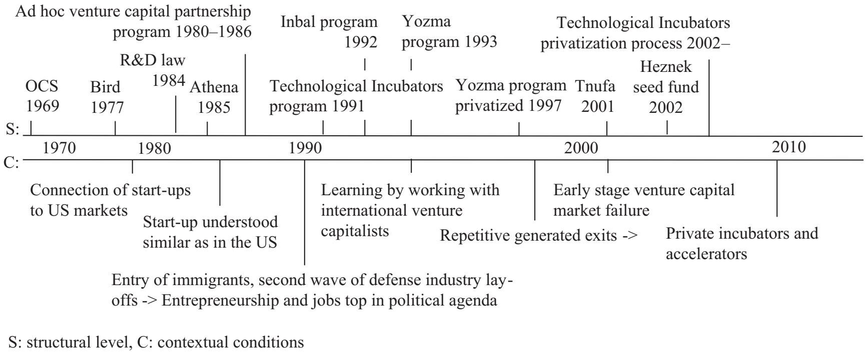

Fig. 2.2 A timeline of key events in Israel 1960–2015

to coding the data into primarily data-based categories (see Ghauri 2004). The different views of the determining features of the start-up industry's activity started to converge to shared perceptions of the primary purpose of the combined activity of entrepreneurship, venture-capital market, and public intervention. These perceptions are intimately connected with the social circumstances and outcomes in the form of international growth venturing, as we will illustrate in the following pages.

Findings

In the shaping of the Israeli start-up industry, we emphasize the evolution of venture-capital interventions and the organization of the start-up industry structure (see Fig. 2.2). The outcomes of the start-up industry's activity are then described on start-up and venture-capital levels. Toward the end of the section, we delineate the concept of the activity-aligning perception as the contextually determined generative force to elaborate on the collective business-building activity of the start-up industries.

The Development and Outcomes of Israeli Start-Up Industry

In Israel, large-scale investment in basic infrastructure projects drove industrialization and economic growth in the 1960s. Large corporations and non-profit organizations were favoured and the political climate was not suitable for entrepreneurship. Due to the continuing security threats, public investment focused on R&D of military technology. The Office of the Chief Scientist (OCS) was established in 1969 to advance industrialization and R&D of the civilian business sector (Breznitz 2006). The government controlled capital markets and restricted the operations of the investment companies.

During the 1970s, public R&D spending continued and increased the amount of technology with business potential. Only one actor provided private market finance. The prevailing conditions pushed few aspiring high-tech entrepreneurs to look outside Israel for finance and competence. The pioneering company in this was Elscint, which with the support of a US-based venture capitalist went public in NASDAQ in 1972 (see Breznitz 2007). The link to US venture-capital and exit markets began to develop. In 1977, the Israel–US Binational Industrial Research and Development Foundation was established to connect Israeli start-ups to the US markets and US thinking about start-ups. The view of venture capital evolved toward the US-based for-profit and exit-focused activity.

By the early 1980s, the availability of capital was not the only problem as the number of willing entrepreneurs remained low. Under these conditions, the OCS even had difficulty in distributing its budget. The government reacted by introducing the R&D law. It increased R&D support to projects with product development in Israel and target market in the USA. The economic recession and a military alliance with the USA led to downsizing of the defense industry. A few thousand engineers were laid off, and many received redundancy packages that enabled them to focus on entrepreneurial activities. The number of entrepreneurs and start-ups increased. The first venture-capital firm, Athena, was established only in 1985, and a special ad hoc program channeled venture capital to 54 Israeli start-ups from experienced US investors (Avnimelech et al. 2004). At least 14 Israeli high-tech firms had initial public offerings at NASDAQ during the 1980s. The activity aimed to develop the products of start-ups to allow for targeting international customer and venture-capital markets and exiting as well.

In the early 1990s, the massive influx of immigrants from the Soviet Union to Israel created an immense economic pressure for job creation. Under these conditions, a large-scale policy shift toward promoting entrepreneurship took place. The government executed a set of policies of which the most important to the development of the start-up industry were the Technological Incubators and Inbal and Yozma Programs (Avnimelech and Teubal 2004; Breznitz 2006). The Technological Incubators Programme established incubators, which focused on creating new start-ups with export-focused products. They, in turn, created demand for the services of venture capitalists. The Inbal and Yozma were complementary, new venture-capital programs. The former was a failure, but Yozma created ten new private venture-capital funds. The government did not intervene with the market, and the funds were managed by experienced international management teams that mentored the aspiring Israeli venture capitalists and supported the portfolio companies. Exits were achieved and private venture-capital funds raised by local and foreign Israel-based venture capitalists totaled over 6.5 billion dollars by 2000—the private venture-capital market took off.

The collapse of the Internet bubble in 2001 resulted in the market failure of early stage venture-capital segment. The government established the Tnufa and Heznek Programs to incentivize venture-capital investment. In addition, a privatization process of the established incubators began to reduce the governmental involvement with start-ups. On the basis of the IVC Research Center (IVC) 2012 data, there are more than 450 private business angels and angel groups active in Israel. Figure 2.2 provides a timeline to summarize these developments in the activity.

As the IVC Yearbook data suggest, Israeli start-ups raised US25.7 billion dollars of venture capital in total between 2002 and 2015. Of the number of IPOs and M&As of venture-capital-financed and non-venture-capital-financed companies documented since the 1990s, Avnimelech and Teubal (2004) identify 80 IPOs of venture-capital-backed start-ups in the US and EU stock exchanges up to 2001. The IVC data also show that 488 venture-capital-backed M&A deals worth US27.3 billion dollars and 56 IPOs raising a total capital of US2.7 billion dollars at the EU, Israeli, and the US stock exchanges were undertaken between 2002 and 2015. The significant growth of the venture-capital activity in Israel indicates the success of start-ups in international markets as well as the efficacy of the venture-capital interventions and the public policy actors that underpinned it.

Determinants of Collective Activity in a Start-Up Industry

In the following pages, we discuss the forces generating the present activity of the start-up industry, by explicating contextual determinants as suggested by the above-documented history and the interview data.

First, since the 1980s, in Israel, the start-up industry emphasized independent entry into foreign markets in general and the US markets in particular as a target for entrepreneurial ventures. Israel is not seen as a market due to the market's small size. This collective perception was strengthened through the historically evolved connection to US thinking about start-ups and the recognized importance of the US customer and venture-capital markets.

> It was very clear that [our] biggest market was in the US, and we targeted the biggest customer there; this was a very defined target for us. (Entrepreneur, venture capitalist) IL)
>
> No market here. (Incubator program director, IL)
>
> You don't have the market here, and you build companies, day one, for international collaboration […] Israeli companies are built; they want to be outbound. (Venture capitalist, IL)

Second, the Israeli start-up industry developed toward incentivizing the creation of new ventures in leadership positions in their market categories. The collective focus is on the envisioned outcome, and it builds on the shared understanding of importance of market leadership and its role with respect to the ability to achieve successful exits. The historical record of exits by Israeli start-ups since the 1990s and the related growth of the private venture-capital market both attract and align the start-up industry actors to approach entrepreneurship from this perspective.

> It's about being very small but thinking about how you can conquer the world. At least in a certain niche, you want to be the best. You need to be the best—the best worldwide in a certain area. (Serial entrepreneur, IL)
>
> If you do a start-up, you want to be the best […] and the next word to disruptiveness [of a start-up] is to build a big company. (Venture capitalist, IL)

Third, the start-up industry's activity is accordingly focused on finding high-potential start-ups and targeting their growth and exits in international markets. Because such ventures are ex ante risky, many start-ups do not achieve the set goals and fail. Hence, growth venturing in Israel is connected with a rather high percentage of start-up closure compared to the number of established new start-ups. For instance, between 2006 and 2010, on average, 42% of start-ups failed (calculated from IVC data, 2011). The attitude toward failure is benevolent, and the importance of learning from mistakes is acknowledged.

> Here in Israel, if you didn't have at least one failure as an entrepreneur, then you are in much worse shape than someone that had one […] How do you get your experience? From making mistakes, obviously you can't be right all the time. (University personnel, IL)

> Failure is forgiven, even appreciated. Try again. If the failure is because you didn't understand the market, because of the legitimate mistakes of the entrepreneur, then you become an experienced entrepreneur. (Venture capitalist, IL)

Fourth, as a corollary, the importance of venture capital is emphasized as a mechanism to select and finance the scaling of start-ups that aim to achieve success in international markets. This is supported both by the availability to international venture capitalists, local business angels, and venture-capital funds and by networks that began to develop in the 1980s. These enable entrepreneurs to not only raise capital, but also to find the right investor who fits the needs of the start-up.

> If you want to take the company to the next level, you don't have too many choices. There are very few companies that have had any serious success a few years down the road and did not take any money from venture capitalists. So, I don't think you have a choice. (Serial entrepreneur, venture capitalist, IL)
>
> You need to choose the right partner for you. I don't think it matters which venture capitalists specifically invest in you; it's which partner you end up working with and what support you end up getting from them. So, it's important to know who is [the person] behind the money. It's true with angel investors and venture capitalists. (Entrepreneur, venture capitalist, IL)

Fifth, a substantial amount of venture capital is invested in stages in the most potential start-ups, in initial and follow-on growth investments. The non-performing start-ups and venture capitalists alike are not refinanced and eventually become outcompeted. This stems from the adaptation to US start-up thinking that has been embraced since the 1980s. Hence, a critical mass of Israeli start-up industry actors provides accountability in terms of the outcome achieved by the invested resources. This manifests as execution pressure on start-ups to succeed in intense international competition.

> In a start-up, [when] you haven't proved your model … you're a company that is losing money. And every day that [the model] still doesn't work means that everything is at stake. And if you don't feel it day-to-day, then you are in trouble […] you need to feel the pressure to move it from the red side to the blue side […] as fast as possible. (Serial entrepreneur, IL)
>
> You have no other way than succeeding internationally because otherwise you don't get return on the investment in research and development. (Venture capitalist, IL)

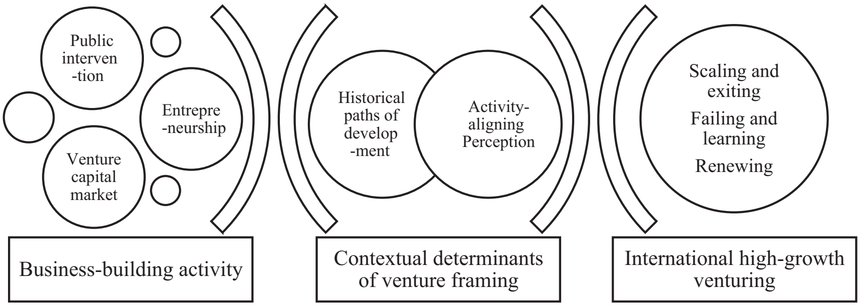

Fig. 2.3 High-growth venturing in a start-up industry

In summary, the analysis of the history, contextual determinants, and outcomes of activity in the Israeli start-up industry allows us to suggest a collectively driven process explaining the emergence/non-emergence of international high-growth ventures in particular geographies (see Fig. 2.3). As the start-up industry is by definition for the emergence of new ventures with potential for high-growth in international markets, the activity consists of the actions of high-ambition entrepreneurship, venture-capital market development, and public intervention in relation to the emergence of these types of venture. Most importantly, this activity is formulated and filtered through the cultural and structural legacies of the past developments and the cognitive-level perception of the target of the activity. The historical paths and the perception intertwine as the contextual determinants of the activity. Through this process, we are able to understand much of the evolution of the start-up industries and their outcomes.

Discussion

International entrepreneurship research has become increasingly interested in the processes and practices of international venturing (e.g., Chandra et al. 2012; Fletcher 2004). Simultaneously, international entrepreneurship research has come to emphasize the micro-processes of individuals and firms in the discovery of rather concrete opportunities in the form of gaps between supply and demand in particular markets (e.g., Hohenthal et al. 2003; Mainela et al. 2014). With our start-up industry-level analysis, we wanted to emphasize the national system-level processes and practices that create the foundation for international high-growth venturing. With this kind of an approach, we can uncover the community's involvement in international venturing and, in that way, the undertakings leading to the emergence of international new ventures (Shepherd 2015).

In terms of theorizing the context (see Welter 2011), we have illustrated the significance of noting the historical and temporal aspects. Prior work on the history of entrepreneurs has highlighted the lack attention to theory about international venturing (Chandra et al. 2015); this is even more so in terms of theory about collective activity by multiple actors. Our study illustrates the way in which the collective activity that manifests as present-day business-building activity is embedded in the historical developments of national economies and the relations established over time between international actors. This contextualization approach allows us to go deeper into the activity of start-up industries and its historical and cultural embeddedness.

On the basis of our study, we suggest that further attention is paid to how the institutionalized perceptions of the target of the collective activity influence international entrepreneurial outcomes. The findings suggest that the start-up industry-level perception of the target of activity vastly defines the collective activity (Liu et al. 2008). The system-level perception is constructed by the in-context embedded rules of the game, institutionalized practices of the community members, and the division of labour factors (Baker et al. 2005; Zander 2004). Therefore, the perception is in constant interaction with the paths of development in the activity.

Finally, policy makers in many developed countries have invested focused efforts on venture-capital market creation since the 1990s (Mason 2009). Despite such significant investment, the results from fostering the appropriate facilitating environment for high-growth venturing have been modest (Lerner 2009). A contradiction between the inputs to business-building activity and its inadequate outcomes exists. Based on our findings, we further suggest that this disparity can be better understood by research that focuses on the identified contextual conditions that frame growth venturing in different regions.

The chapter is limited in terms of the conceptualization of the business-building activity's actor structure. In the present-day entrepreneurial environments, there are also other actors apparently involved, who might have a significant bearing in the whole entrepreneurial ecosystem (Sipola et al. 2016). The Israeli focus of our chapter and the importance of start-up and venture-capital market co-evolution in growth venturing of this nation (see Avnimelech and Teubal 2006) provided particularly interesting insights into the collective activity of the examined economic actors.

Conclusion

The analysis of the collective activity in start-up industries allows us to illuminate country-based contextual factors and further analyze the embedded social practices influencing the productivity of growth-focused ventures (see Baker et al. 2005). It asks us to search for the internal and systemic generative mechanisms within the actual activity and to pay further attention to the emergence and temporality of international opportunity-oriented collective growth venturing.

We wish the present study to invite discussion on themes that merit further investigation. With respect to international entrepreneurship research, researchers have called for further attention to samples and their characteristics (Coviello 2015; Coviello and Jones 2004). The concept of start-up industry suggests that high-ambition and high-reward-potential young ventures, aiming at global leadership, represent a specific type of new ventures. We propose that they possibly have logics of success and failure that differ from other types of international new ventures or born global firms. These logics emphasize, for example, the functioning of the structures of venture-capital intervention and exit markets instead of general entrepreneurship environments or institutional settings for national innovation management. This makes high-growth venturing a particular growth frontier in international business.

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3

SME Internationalization, Public Policy and the Growth Agenda

Igor Kalinic and Jeremy Clegg

Introduction

Small- and medium-sized enterprises (SMEs) comprise some 90 per cent of firms in most countries. While the majority have operations limited to their native economy alone, a growing number of SMEs are active in international commerce. SMEs are often the major source of technological innovation, of industrial upgrading and of the opening up of frontiers of new industries. The true extent of their contribution to individual national economies is very considerable and difficult to grasp (Cernat et al. 2014). The widespread decline in barriers to trade and investment associated with the globalization of markets, together with technological advances in communications, is now enabling SMEs to anticipate becoming direct participants in international business soon after establishment (Oviatt and McDougall 2005) so increasing the number of international SMEs.

SMEs represent the fastest-growing cohort of international firms. Over the period 1992–2007, the exports of US SMEs have doubled, and in Japan imports increased 74 per cent and exports increased 62 per cent. Within the European Union (EU), 33 per cent of native SMEs are internationalized (European Commission 2010b). Elsewhere, SMEs account for about one-third of exports from Asia and about a quarter of exports from developed

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countries in the rest of the world, including the USA. In selected countries such as Italy, Ireland and China, SMEs contribute 50 per cent or more of total national exports (Cernat et al. 2014; Hilgers 2009).

International business is a potentially expensive undertaking and requires the firm to deal in foreign languages, cultures and unusual ways of doing business—these are known as the costs, or liability, of foreignness or, more generally, of outsidership (Johanson and Vahlne 1977, 2009; Zaheer 1995). Compared with doing business in the familiar home market, international business is complex and challenging (Johanson and Vahlne 2009), and these bear disproportionately heavily upon SMEs. Compared with leading firms, SMEs not only are characteristically small in size, but also exhibit youth and inexperience, while lacking substantial financial and human resources (Nakos et al. 2014; Wright et al. 2007). For SMEs, there is a fine balance between (international) growth and performance (Sapienza et al. 2006). In particular, management may be either short-handed or deficient in superior business skills, or both. Small size and lower levels of resourcing make SMEs vulnerable per se, for several reasons: they often operate on slim profit margins and across a narrower base of revenue streams (Westhead et al. 2001). And when internationalizing, empirical evidence points to the possibility of an injudiciously heightened level of international commitment by these firms, despite the considerable uncertainty they face—notwithstanding their poor resourcing, inadequate knowledge of the foreign market and scant international experience (Kalinic and Forza 2012). Under such conditions, SME entrepreneurs frequently turn to their networks to overcome the liability of outsidership and base their investment project decisions on the affordable loss principle. They also adopt flexible goals rather than return-on-investment calculations and the detailed business plans that typically are the basis of professionalized business planning (Kalinic et al. 2014).

Yet, for all these firms' frailties, many economies have pinned their hopes of growth upon the SME segment of domestic industry, expecting them to perform the role of a national productive "centre of gravity", as exemplified by *Europe 2020: A Strategy for Smart, Sustainable and Inclusive Growth* (European Commission 2010a). The logic is that SMEs can be presumed to be more firmly rooted in the home economy than might be the case with established, but more footloose, multinational enterprises. But, at the same time, governments recognize that SMEs have to be internationally competitive in order not to be outcompeted within their domestic market.[1] To gain this competi-

[1] For example, see *"Think Small First"—A "Small Business Act" for Europe* (European Commission 2008) and *Study on Support Services for SMEs in International Business* (European Commission 2013).

tive ability, SMEs need to be able to establish abroad so as to learn how to compete effectively, on the same terms as their peers. Export, foreign direct investment and non-equity-based competition abroad are therefore crucial to the performance of the SME sector, and to income, employment and growth in the home economy. However, how best to design policy for the domestic SME sector in general, and particularly with respect to SME internationalization, remains poorly understood. It is a remarkable fact that the availability of public support for internationalization goes largely un-noticed. According to a European Commission study (European Commission 2010b), only 16 per cent of European SMEs are aware of public support initiatives for internationalization, and only a limited number of SMEs use public support. In the USA, only 23 per cent of exporting manufacturers have used public support designed to promote exports (European Commission 2010b).

Therefore, in this chapter we place particular emphasis on the interaction between public policies, and other measures, to stimulate commercial and financial practice instrumental to promoting internationalization. This is an area that merits systematic research, as so many economies employ such measures, aspiring to harness the SME sector to the generation of economic growth at home. The topic of policy action for internationalization is prominent in the political programmes of Europe and elsewhere. For example, in the EU the backdrop is the Growth Agenda (prominent in the plans of the Juncker Commission) which hinges to a large extent on SMEs and entrepreneurial firms contributing to growth (again, particularly via internationalization). But exactly how the mechanisms of promotion—issues to do with the availability and terms of finance, awareness-raising measures, knowledge acquisition measures, capacity-building measures and so on—work needs to be fully comprehended, and then utilized, to serve the ultimate objective of contributing to economic growth. An effective SME internationalization policy aimed at enhancing international entrepreneurship is needed, taking into account the perspectives of all the key actors involved, broadly speaking policy makers and practitioners, together with academics.

We start by reporting some characteristics of the SMEs sector at the EU level, to underline their crucial role in the economy and their importance for the international dimension. We then discuss (1) perspectives taken within academia to analyze the topic of SME internationalization, (2) policy initiatives at the EU level and (3) perspectives from commercial and financial practice. In the second part of the chapter, we discuss the interaction of the spheres of policy, finance and the Growth Agenda, and how collectively they enhance the internationalization of SMEs. Finally, we present a number of avenues for inquiry that need to be addressed in future research.

SMEs and Internationalization: EU Dimension

SMEs are the backbone of the European economy. In the EU, SMEs account for 99 per cent of all businesses (European Commission 2015a). They represent 67 per cent of total employment and create 8 per cent of gross value added. The EU institutions (by which we mean, principally, the Commission, the Council and the Parliament) conceive of internationalization as being categorized as either (1) within the EU single market or (2) outside the EU, involving third countries. According to data from the European Commission (European Commission 2010b), SME internationalization is important for four reasons. First, international activity by an SME correlates strongly with higher turnover and growth. Second, SMEs that are internationally active tend to report higher rates of employment growth. Third, there is a strong and positive relationship between internationalization and innovation. And last, the drivers of SMEs' growth are increasingly found to be within emerging markets and the fast-growing economies of third countries beyond Europe. In fact, according to the study *Internationalization of European SMEs* (European Commission 2010b), internationalized SMEs report employment growth of 7 per cent versus 1 per cent for those without any international activities. There is also a strong relationship between SME internationalization and innovation. Twenty-six per cent of international SMEs (versus only eight per cent of domestic SMEs) introduced products or services new to their domestic sector. EU SMEs classified as international are mostly active in the EU internal market—only 13 per cent are active in the markets of third countries.

The fact remains that only a small proportion of European SMEs are doing business at the international level either within or beyond the EU. A recent "Eurobarometer" study on SMEs' internationalization (European Commission 2015b) indicates that 33 per cent of EU SMEs have been involved in exporting to another country either inside or outside the internal market in the last three years, with 30 per cent of those SMEs having exported to another EU country. Yet, almost 74 per cent of the SMEs that do not currently export indicate that they would probably never do so. For these firms, the problem they face is the frequent absence of a proper functioning market for providing basic SME internationalization assistance and services. And the leading reason for this is that most SMEs are not able to afford the services that do exist, as these are mainly designed for big companies. This explains why public authorities have developed a variety of different support schemes at local, regional, national and European levels (e.g., see European Commission 2013).

Academic Perspective

From the academic point of view, the discussion can be grouped into three broad areas. The first area provides the entrepreneurship/innovation perspective, that is, it focuses on how entrepreneurs and SMEs realize international opportunities; that is, the entrepreneurial processes of learning, networking, collaborating and creating and exchanging knowledge within smaller firms. This perspective explores the capabilities and motivations of SMEs that antecede internationalization. The main research questions are thus: (1) How do entrepreneurs and SMEs identify/create international opportunities? (2) What are the main threats, obstacles and challenges for entrepreneurs and SMEs to initiate international expansion? (3) In particular, what are their main requests to governmental and other institutions? (4) What is the role (and potential role) of public policy and laws in stimulating international entrepreneurship?

The second area focuses on the strategy and growth perspective, that is, on how to transform opportunity into a sustainable and well-performing international venture. This comprises entry and establishment mode choice, export channel selection and competitor identification. Appropriate entry mode choice and export channel selection are crucial, as the mode adopted on entry is very costly to change, and, therefore, it is important to make the correct initial selection, especially for resource-constrained enterprises, such as SMEs. This perspective therefore highlights the decisions that are made by firms and the effectiveness of the decision making. For example, do firms have access to the relevant information, and to the professional skills required for international strategy formation? Answers to these questions will deepen our understanding of the likely receptiveness of SMEs to policy interventions. Here, the main research questions are these: (1) What are the main challenges for SMEs to develop a sustainable and high-performing international expansion? (2) What supportive measures—issues to do with the availability and terms of finance, awareness-raising measures, capacity-building measures and so on—do SMEs need, to foster internationalization growth? (3) How do we balance international performance and growth?

The third area focuses on the institutional perspective, that is, on how institutions and policies can assist the internationalization process of SMEs; that is, the relation between the theory of policy intervention and SME internationalization. This perspective therefore looks at the overarching question of how our academic and scientific knowledge and understanding of SME internationalization interacts with the institutional and policy dimensions. The main research questions are as follows: (1) How do the public and private sectors evaluate SMEs' international business projects? (2) In conditions of high uncertainty—typical for the internationalization of SMEs (being resource limited) in which it is not possible to estimate the return on investments—do finance providers make their financing decisions on different grounds for SMEs as compared with large corporations? (3) What kind of new, if any, tools are governments and the private sector searching for with which to promote SME internationalization, and what tools they ought to be seeking? (4) What future theoretical developments are needed?

Initiatives at the EU Level

The European Commission has instituted a number of initiatives to support SMEs in general. The most important reference document is the Small Business Act, launched in 2008 and reviewed in 2011 (European Commission 2008, 2011, see also http://ec.europa.eu/growth/smes/business-friendly-environment/small-business-act/index_en.htm). This Act contains a set of guiding principles which have been decided by the EU to direct member states towards issues that require careful attention. The Small Business Act is focused on access to finance, fostering entrepreneurship and facilitating access to markets for SMEs (including the international dimension). More practical support for internationalization is offered through some of the actions set out below:

- *Enterprise Europe Network* (http://een.ec.europa.eu/). In each European country, there is a network which is funded by the European Commission and which is constituted mainly by chambers of commerce and regional business representative organizations. This network has the task of advising SMEs, facilitating access to international markets and helping with the identification of partners in third countries.
- *EU SME Centre in China* (http://www.eusmecentre.org.cn/). This is a very light structure which offers a first line of advice for European SMEs considering entering the Chinese market. They have a web-based diagnostic tool for SMEs to check if they are ready to enter the Chinese market. They also organize training sessions and information sessions on do's and don'ts when entering the Chinese market.

- *SME IPR Helpdesk* (https://www.iprhelpdesk.eu/SME_Corner). This is an agency specialized in advising SMEs on the protection of intellectual property. There are three helpdesks focused on different geographic regions: greater China, South East Asia and Latin America.
- *European Investment Plan* (http://europa.eu/rapid/press-release_IP-14-2703_en.htm). Through the European Investment Bank, the European Commission supports certain national banks to ease access to finance for SMEs.
- *SME-specific credit risk assessment*. The European Commission is developing a specific credit risk assessment method which is tailored to SMEs, to take account of their specific and distinct needs compared with larger companies.

Banking Sector Perspective

There are three salient contextual elements for SMEs' internationalization that banks take into consideration: confidence, competence and connections.

- *Confidence* to cross the border, which is of two types. First, "Border out" is everything that a country does in support of its businesses in the market beyond its borders (e.g., marketing, promotion and sponsorship). Second, "Border in" is everything that a country can do to support the improvement of competitiveness (e.g., knowledge, skills and attitude) within the businesses themselves, in order to be ready to take advantage of the opportunities beyond the border. "Border-in" intervention is by far more effective in generating improvements in SME internationalization performance. The challenge is to find out how to improve the competitiveness of businesses rather than simply generating more opportunities for them.
- *Competence* is composed of two dimensions. First, the level of business competency refers to SME capabilities and can be categorized as follows: inexperienced, experienced or expert in internationalization. Second, the nature of business support can be categorized as being information, advice and assistance. For each SME it is important to identify what kind of support is needed. Inexperienced SMEs search for information; experienced SMEs look for advice and expert SMEs need assistance.
- *Connections*. Large multinationals are very well globally connected. SMEs, on the other hand, are poorly connected, and a global map of SME connections would be much more fragmented and fractured.

The banking sector views innovation as a necessity for successful businesses, particularly those engaged in internationalization—the logical reason being that the firm must be bringing something new to the market. According to this view, innovation is a function of ideas and ideas are a function of connections. So, the conclusion is that policy should promote the formation of connections that are found in networks, in order to help SMEs generate ideas. The principle is that these networks deliver content, facilitate collaboration between members of the networks and facilitate connections with other networks.

In summary, in order to promote the internationalization of SMEs, policy makers, financial institutions and companies themselves should (1) focus on Border-in, rather than Border-out approaches, (2) use a competency matrix as the basis for establishing the nature of support required and (3) deliver content, collaboration and connections via networks.

Evergreen Problems with SMEs' Internationalization: Some Ways Forward from Practitioners and Policy Makers

Practitioners in the banking and financial sector and EU policy makers have highlighted some of the same issues as academics, such as the costs of internationalization, risk and access to information and resources. However, they have gone further to identify concrete questions that require concrete actions. Here, we review these questions, the policy response and the remaining policy gaps.

The leading questions from practitioners in business and policy circles are thus: How can SMEs get hands-on experiential knowledge of internationalization, at low risk and low cost? What initiatives from the banking and financial services sector, and what new policy perspectives address, or will address, the problem of inadequate experience? In answer to the demand for action, the following are representatives of current practitioners' and policy makers' guidance:

- Erasmus for young entrepreneurs (http://www.erasmus-entrepreneurs.eu/). This is a programme that the European Commission started in 2009, which allows a young (i.e., non-experienced) entrepreneur to spend from one to six months in a different country with an experienced and successful entrepreneur. Usually the entrepreneurs going abroad are under 40 years of

age, and the host entrepreneur is below 50. The programme is focused on learning by doing at relatively low cost. After five years of this programme, evaluation shows that 90 per cent of the programme's new entrepreneurs acquired knowledge about new markets during the exchange; 80 per cent of new entrepreneurs established a broad range of international contacts. And nearly two-thirds of host entrepreneurs reported that they also benefited from the experience by acquiring knowledge of foreign markets through hosting the young entrepreneurs.
- Employ international resources that are relatively easy to access and are nearby. For example, international students (via internships or placements). Such a strategy confers knowledge of the home markets of the students on the SME and helps to facilitate connections with these markets to the benefit of the SME.
- Recruit people who are already internationally experienced.
- Participate in trade missions, including inward trade missions, and exhibition visits.

A universal question is this: How are the support programmes for SMEs' internationalization promoted, that is, how do you reach the SMEs? The issue of raising awareness of programmes' existence and of effective communication is crucial to firms being in a position to benefit. The mechanisms include:

- Bank promotion through a number of directors in local branches that have a portfolio of companies. It is the responsibility and duty of these local branches to push information and opportunities to their customers. In addition, banks also maintain active contact with trade associations, accountants, lawyers and universities to employ their networks for communication with SMEs.
- The European Commission usually does not itself communicate directly to SMEs because the target audience is both very broad and diverse. Rather, the Commission passes information through business intermediary organizations. Recently, the Commission started to organize regular meetings with national trade promotion organizations to share best practices and to develop common approaches across the EU for the support of SMEs' internationalization.

Given the need for the expenditure of resources, in particular innovation, the question arises: Does internationalization have any effect on the (potential) bankruptcy risk of SMEs, and does the innovation intensity of internationalizing SMEs have any effect on the (potential) bankruptcy risk of the SMEs? To date, the answer seems to be that:

- Internationalization does affect the potential bankruptcy risk of SMEs. All SMEs operate relatively close to breakeven, because this is the nature of business for SMEs. However, while there is no correlation between internationalization and profitability, profitability should exert a mitigating effect on the potential for bankruptcy risk.
- Innovation, being necessary for internationalization, should mitigate the risk associated with internationalization. Innovation intensity should then reduce the potential for bankruptcy risk, as it increases the probability of success.

A crucial question that lies outside the strictly economic domain, and to which the answer is at least in part, likely to be socially determined is this: How is failure considered and what are the possibilities regarding alternative sources of financing? This question may be at the root of international differences in entrepreneurial risk taking. Within the EU and, as is exemplified well in the UK, traditional lenders (i.e., banks) are the dominant source of finance:

- The risk algorithms that traditional lenders employ dictate the decision to finance. This means that people who have previously experienced business failure inevitably score a range of "red lights". Even so, in cases of high risk scores, some banks will offer two alternatives. First, to pull in other potential sources of finance—for example, venture capitalists, crowd funders, other banks—to reduce the risk for the individual bank concerned. Second, to provide non-financial ways to support the firm, such as through financial consultancy, assisting access to new customers, recruiting productive people into the business and reducing costs.
- The European Commission, being aware of the problem of finance for firms that appear to be risky for reasons of legacy, is promoting greater action at the national level to give second chances to entrepreneurs.

Discussion

The EU, its member states, the USA and the advanced economies in general look at their SME sectors to emulate the industrial growth performance of the world's high-growth—today, typically the emerging—economies. In the context of the developed economies, it is necessary to adopt an effective

SME policy towards internationalization, not least because internationalization alone offers the growth opportunities that SMEs require. The evidence demonstrates that policy should be aimed at enhancing international entrepreneurship and be designed with due account taken of the perspectives of all the relevant actors, that is to say, policy makers and practitioners, and also academics who, through research, education and training, have the potential to aid the design and optimization of policy. The concrete actions that transpire as promising are (1) strengthening the partnership between the private and public sectors, (2) the provision of educational programmes for SMEs, (3) the expansion of loans and loan guarantee programmes and (4) the provision of better intelligence support. To enable this, future research is needed to focus on the following areas:

- *Strengthening the partnership between the private and public sectors.* There are certain things that government does especially well, and others that the private sector does especially well. In the USA, for example, the federal government is strong at market research, financing and coordinating certain types of efforts beyond the means of SMEs. This type of private–public partnership needs strengthening and further development in Europe.
- *The provision of educational programmes for SMEs.* At present, numerous governments offer educational programmes in general business and international trading opportunities. However, training on internationalization and related topics specifically tailored for SMEs remains limited. Such training can be underpinned through workshops, seminars and other educational programmes that might, for example, be offered to SMEs by government agencies, based on sound research to establish what works best. The state of scientific knowledge on the requirements of SMEs, and on the mechanisms through which policy actually works upon them, is inadequate, and at present it remains unclear what the projected effectiveness of policy interventions will be. Sufficient evidence on the objective value of such programmes has not yet been established.
- *The expansion of loans and loan guarantee programmes.* Perhaps the greatest problem that small companies are reported to face in internationalization is accessing sufficient capital. The problem can be addressed via low-interest loans and loan guarantees. Numerous government agencies provide such loans, but these schemes often do not reach SMEs—their intended target. Evidence from Europe and from North America both suggests this. Of itself, this offers scope for theorizing as to why this might be the case. Such support programmes are especially important for SMEs because many such firms may be unable to obtain, or to afford, loans from conventional, pri-

vate sources. Research into policy intervention generally suggests that programmes need to be promoted more effectively and expanded. The problem of awareness is persistent and ubiquitous—a failing which demands concerted research.

- *The provision of better intelligence support.* It is the role of public and private suppliers of market research and intelligence to cater to SMEs, to assist them in preparing for and dealing with internationalization efforts. But what is the optimal level of this public support, and how far is it contingent upon support for building capabilities first, that is, Border-in interventions?
- *The encouragement of free trade and economic development worldwide*. Just as barriers to transacting domestic business bear disproportionately upon nascent and smaller enterprises, in the international domain, the effective and efficient governance of international trade and investment is particularly important to SMEs. The ideal position is that the World Trade Organization and numerous major governments should continue to encourage and stimulate free trade and economic development around the world. Free trade is theoretically, and is demonstrated to be, the most effective means for alleviating poverty in developing economies—though contingent upon other supportive policies, for example, as directed towards the Sustainable Development Goals (United Nations 2016). National economic health and national stability depend to a large extent on economic development that is stimulated by international trade. In the post-Doha world, with a lack of closure in multilateral barriers reduction, the leading economies, and economic groupings, are increasingly pursuing non-multilateral trade and investment policies. It is an open question, but amenable and suitable for research to consider, how the deviation from multilateralism might impact upon the representation of SMEs' best interests within this new generation of agreements—for instance, within the projected Transatlantic Trade and Investment Partnership and, in turn, upon the internationalization of SMEs.

From the above agenda, we can draw immediate questions for future research that will be extremely useful to enhance the internationalization of SMEs. First, a large number of programmes offered both by the public institutions and by the private sector are passive. In other words, it is up to the individual SME to be interested in internationalization and go looking for support. This underscores the perennial issue of poor awareness of the support available—but also that only a third of European SMEs are interested in internationalizing. It remains a question for research as to how the remaining two-thirds can be shifted towards the international involvement that will be necessary to serve the Growth Agenda. What more, that is proactive, can be done? Second, is it necessary to be first innovative and then become international? It is a common understanding that it is the innovative firms that transition to going international, but what evidence is there that going international will help SMEs to become more innovative, as prima facie, appears to be the case for the rising tide of entrepreneurial firms from the emerging economies. What then is the relationship between internationalization and innovativeness? Third, what is the relationship between the ability of a certain region to trade strongly with foreign countries and its attractiveness in terms of inward investment? In other words, is there a spillover effect between the promotion of internationalization by local SMEs and the ability to attract foreign investments? And, finally, what are the fundamental causes of the marked and persistent differences between economies in the rate of new enterprise start-up, the turnover of enterprise and the long-run size and international growth of the SME sector and, in particular of the inferior growth within Europe as compared with the USA?

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4

‘After-Care’ Service Provision and Repeat Investment

Paul Kalfadellis and Susan Freeman

Introduction

The economic benefits that can accrue to a location as a result of inward foreign direct investment (FDI), in the form of access to capital, innovation spill-over effects, greater productivity and the provision of employment opportunities among other benefits, are well known (DFAT 2016). Governments have sought to establish and provide a greater role for their inward investment promotion agencies (IIPAs) not only in terms of attracting the initial FDI into their domain (Anderson and Sutherland 2015), but also by looking to make their locations ‘sticky’ (Markusen 1996), such that multinational enterprises (MNEs) would be reluctant to leave. Support offered to established foreign subsidiaries to continue to engage in repeat investment in a location has become an important feature in both ‘cementing’ existing operations and aiding a region’s economic development (Fuller et al. 2003). For example, for the highly rated and regarded IIPA—IDA Ireland (Site Selection Magazine 2015)—the development of long-term partnerships with established clients is considered fundamental to the agency’s work, as it looks ‘to assist them in

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continually improving and transforming their Irish operations and identifying new areas of opportunity' (IDA Ireland 2014, p. 26).

For both national and regional locations, repeat investment is an important vehicle for adding to the overall stock of FDI within economies. The growing number of established foreign subsidiaries helps to add to this stock by providing opportunities for the further expansion of operations through repeat or reinvestment (UNCTAD 2007). According to Phelps and Fuller (2000), repeat investment requires a greater understanding and appreciation as the positive benefits and spill-over effects to be gained from repeat investment can prove to be ultimately more beneficial than the initial investment attracted to a location. Repeat investment which includes retained earnings or additional capital re-invested by established MNE operations (Luo et al. 2008) incorporates '…any significant investment in plant, equipment or human resources subsequent to that of initial entry into an economy…' (Phelps and Fuller 2000, p. 225) carried out by a foreign firm. Repeat investment can help explain an MNE subsidiary's enhanced status, embeddedness and development within a location (Phelps and Fuller 2000) and is often indicative of the evolution and upgrading of the operation mandate given to a local subsidiary (Birkinshaw and Hood 1998; Mudambi 1998; Paterson and Brock 2002). This upgrade of the operation mandate can subsequently help facilitate the economic development of both national and regional economies in which the subsidiaries are located (Phelps and Fuller 2015).

A sizeable proportion of the FDI inflows received by countries comes in the form of repeat investment from retained earnings or additional capital from established MNEs (Luo et al. 2008). The initial investment by an MNE often represents a fraction of the potential investment an established MNE subsidiary is likely to invest in a location (Andersson and Persson 2006; Phelps and Fuller 2000). In Ireland, for example, it is estimated that 70% of FDI investment comes from existing clients (IDA Ireland 2014), and in the UK, repeat investment accounts for over half of all inward investments (Phelps and Fuller 2000). In Australia, foreign MNEs are said to re-invest 50% of their total income earned (DFAT 2002). Accordingly, Fuller and Phelps (2004) have argued that there is a need to look beyond the location factors associated with the initial investment decision and consider those factors that are likely to impact on the subsequent repeat investment in a location.

Morgan (1997) sees the role of IIPAs as agencies located between the State and the market and acting more and more as conduits between institutions facilitating exchange of information and learning within regional networks. There are fewer activities, compared to those surrounding the initial investment attraction carried out by IIPAs, that focus on the long-term maintenance of existing investments (Raines 2003). This is despite an awareness among governments and their IIPAs of the importance, for a location's future economic growth potential, of the repeat investments they continue to receive (Raines 2003).

It is in this context that this study seeks to explore the issue of repeat investment through the provision of 'after-care' services. According to Young and Hood (1994, p. 51), 'after-care' services are '…all the potential services offered at a company level by government and its agencies designed to facilitate both the successful start-up and the *continuing development of a multinational affiliate* … with a view to maximizing the local development contribution of that affiliate' (*italics added by author*). For most IIPAs, their focus and efforts are expended on the pre-investment services that attract the initial FDI rather than 'after-care' services (Narula and Dunning 2010; World Bank Group 2012). However, according to *Site Selection Magazine* (2015), highly rated and well-credentialed IIPAs at both the national (e.g. IDA Ireland, CzechInvest) and sub-regional levels (e.g. Business Birmingham, InvestKL Malaysia) are associated with a range of positive attributes, including the 'most user-friendly databases' of location sites and incentives both for general and sector-specific investment; the 'most appropriate information' pertaining to timing expectations for investment permits and the like; and interestingly, from a repeat investment perspective, the best reputation for the provision of 'after-care' services (Site Selection Magazine 2015).

The present study adopts a subsidiary perspective in examining the issue of the provision of 'after-care' service, because MNE subsidiaries, by signalling to headquarters, play a significant role in initiating investment in the development and expansion of its own resources and capabilities (Davis and Meyer 2004). This typically comes about as a result of a greater understanding and evaluation, by the subsidiary, of the local environment and the opportunities and advantages to be found within it (Davis and Meyer 2004). In light of the above discussion, this chapter reports on a study that investigated *the attitudes of foreign subsidiary managers operating in Australia to the provision of 'after-care' service and its relationship to repeat investment*.

In seeking to understand the operations of MNEs, it is important to try and delineate, where possible, contextual factors that can impact upon MNE operations (Andersson 2004). The present study's exploration of the firm-specific factors of firm size and age thus reflects the search for a more nuanced understanding of the relationship between the provision of 'after-care' service and repeat investment. This chapter is structured in the following manner. A brief review of the literature on IIPAs and government 'after-care' services follows. Discussion then moves to the justification of the firm-specific factors that are examined. The data sources, method used and the results of the study are outlined, prior to a discussion of the contributions and suggestions for future research.

Literature Review

Inward Investment Promotion Agencies and 'After-Care' Service

Globalization has encouraged a degree of convergence in the promotion activities of IIPAs throughout the world (Raines 2003). Wells and Wint (2000) suggested that these activities can be classified according to 'image-building'—that involves highlighting a location's advantages; 'investment-generating'—identifying and enticing potential investors to a location; and 'investment service'—assisting investors with the initial project set-up. Less attention, however, has been devoted by IIPAs to the provision of 'after-care' services which seek to cement existing investments in a location (Raines 2003). Despite 'after-care' services being recognized as a core function of IIPAs (UNCTAD 2007), a study of IIPAs conducted by UNCTAD (2007) did not feature 'after-care' service highly in terms of resource allocation among the surveyed IIPAs. Yet, when asked about the importance of generating reinvestment or the expansion of existing investment, the majority of IIPAs deemed this a high priority (UNCTAD 2007).

IIPAs have found themselves performing a balancing act between investment attraction and investment maintenance. On the one hand, they try to increase asset specificity in their location with regard to existing investment, while, on the other hand, also trying to maintain the appeal of their location to non-specific asset investments (Raines 2003). To accommodate this balancing act between attracting new investment and repeat investment from an existing investor, IIPAs have coped by engaging in differentiation, discrimination and embedding strategies (Raines 2003).

Differentiation

Through a differentiation strategy, IIPAs have over time put more emphasis on the unique assets to be found in their region or country. This policy seeks to differentiate their region from others, by highlighting the uniqueness of the location in their marketing programmes as distinct from the generic advantages talked about by most locations (Raines 2003). As Bristow (2005) argues, associating different regions and locations with a 'one size fits all' list of key success factors without prioritizing those factors in order of importance or suitability to, or tailoring them to the location and historical antecedents of, particular regions often results in 'identikit' competitive strategies, which tend to be unhelpful to the regions' perceived 'institutional thickness' (Amin and Thrift 1994). A differentiation agenda seeks to address this, by adopting strategies that are territorially specific (Raines 2003). By focusing on sectoral interests, IIPAs look to move away from generic strategies of attracting FDI to focusing more on localized strategies that encourage the development of sectoral niches in existing locations. The differentiation strategy adopted by IIPAs is closely aligned with their targeting of strategic sector-based investment (Raines 2003).

Discrimination

Informed discrimination, according to Raines (2003), adds to the promotion of specific industries in a location, by identifying specific sub-sector niches and key player companies whose presence in an economy can add to the overall strength and competitive advantage of the location in that economic sphere. The danger here is to avoid the narrowing of the industry base by targeting specific niche sectors to the exclusion of a broad range of investments (Young et al. 1994). IIPAs also seek to upgrade the type of investment, by trying to attract more high-value-added types of investment that rely upon greater R&D, which may result in spill-over effects for the local economy. The reliance solely on assembly-based investments, it is argued, potentially will not have long-lasting benefits for regional economies (Sheppard et al. 2009).

Embedding

Lovering (2003) points out that places, like commodities, face a growing competitive environment. For many regional and local governments, the inward investment policy is increasingly characterized by policies that seek to embed the existing investor in the location in which they operate (Lovering 2003). Development bodies, regional and local governments and research centres are all seeking to complement the work of the IIPAs, by extracting more value from the existing investor (Raines 2003). However, it is important they also avoid putting 'all their eggs in one basket', by focusing resources solely on high-profile subsidiaries. Problems can arise for local governments when the MNE subsidiary has secured all the location assets, while at the same time, the region is not able to exploit the assets offered by the firm (Phelps and Fuller 2000). Take, for example, the rapid decline in the locational attractiveness of the Australian auto industry in more recent years, after several decades of repeat investment (Cavanagh and Freeman 2012). The potential risk of total dependency by a region becomes even more pronounced when localized and 'embedded' investment that has been the focus of government resources in terms of 'after-care' service ultimately closes down or shifts to another location (Raines 2003).

In examining MNEs' embeddedness within a location, Fuller and Phelps (2004) surveyed companies in the electronics-related sector in Wales and Ireland. They sought to determine the location factors which encouraged repeat investment among foreign MNEs. They found that traditional cost-based advantages relating to labour, including proximity to market, grant assistance and tax incentives (with regard to Ireland), were considered more important than the provision of 'after-care' services in attracting repeat investment into both Wales and Ireland. However, Fuller and Phelps (2004) did note that the issue required more in-depth analysis considering the qualitative nature of their inquiry.

It is the task, therefore, of public sector bodies such as IIPAs to provide 'after-care' services and work with a broad range of subsidiaries and other local 'players', both public and private not only to win but also to sustain significant repeat investments (Raines 2003). This is especially true when the repeat investment involves a potential upgrade in the role and mandate of the MNE subsidiary (Birkinshaw and Hood 1998; Delany 1998). The development of the subsidiary through role upgrade (Birkinshaw and Hood 1998) within the MNE organization can lock in greater longevity for the subsidiary, while at the same time benefiting the local economy (Raines 2003).

'After-care' service has meant that IIPAs have had to adapt to the new investment environment and the localization pressures that ensue (Raines 2003). According to Phelps and Fuller (2000), the extent to which IIPAs have been effective in retaining investment is debatable. Studies carried out by Birkinshaw and Hood (1997) in Canada and the UK found an increasing importance in the role of IIPAs whose brief extends beyond the attraction of 'greenfield' investments to incorporate maintenance and encouragement of subsidiaries to increase their investment. The role of IIPAs was also highlighted in the provision of 'after-care' service by many host governments in the belief that they can influence the further development and embeddedness of MNE subsidiaries in their locations (Birkinshaw and Hood 1998). This was confirmed by Miskinis and Byrka (2014), who found that highly successful IIPAs were those that engaged in 'after-care' activity and as a result were able to attract repeat investment inflow into their locations. 'After-care' services may involve making representation, by government and or its agencies (IIPAs), to MNE headquarters on the subsidiary's behalf; the provision of post-investment support by investment agencies taking the form of further incentives, such as grants, subsidies, tax holidays; or the provision of specific remedial help to subsidiaries in order to guarantee their continued existence in a location.

In light of the above discussion, our first hypothesis contends that:

H1: *'After-care' service provision will be positively associated with repeat investment in Australia.*

Subsidiary Size Effects

In considering the resource-based view (RBV) of the firm (Barney 1991; Penrose 1959; Wernerfelt 1984), the size of the firm is one of the indicators of a firm's resources and organizational capabilities (Dhanaraj and Beamish 2003). Challenges faced by small (1–20 employees), medium (21–200 employees) and large companies (over 200 employees) (ABS 2001) are not necessarily the same, as small- and medium-sized enterprises (SMEs) differ from large enterprises in a number of ways. The size of a subsidiary has been found to affect the problems encountered by MNEs, and the perception of the importance of location factors by manufacturing firms differed according to firm size (Lu and Beamish 2001). Small firms face a number of challenges due to their size, including a lack of access to markets, resources, information and finance. SMEs also often find themselves with a lack of infrastructure or business support that is provided to larger firms by governments (Harvie and Lee 2005).

Larger firms have been found to be better able to handle the greater complexity and avoid potential problems and shortfalls that may arise abroad following internationalization (Prashantham and Young 2011). Their greater experience of dealing in the foreign environment may enable them to gain the 'ear' of the local government and negotiate from a stronger position with host governments (Vachani 2005), and they are likely to have greater resources at their disposal to manage their operations (Nachum and Wymbs 2002). This suggests that established large foreign MNE subsidiaries are more likely to command the 'attention' of governments and can, by being better resourced, more readily engage in repeat FDI.

In light of the above discussion, hypothesis two contends that:

H2: *'After-care' service provision will be positively associated with repeat investment in larger subsidiaries compared to smaller ones.*

Subsidiary Age Effects

Previous studies show that as MNE subsidiaries become more embedded in a location over time, they 'cement' their presence and adapt to the location and its environment. Townroe (1975), in his work on the adaptive behaviour of branch factories, found that over time the embeddedness of these branches in a location resulted in an evolution of linkages and relationships between the subsidiaries and the different institutions, firms, government and non-government organizations existing in the location.

The obsolescing bargaining model suggests that over time, changed circumstances, whether of the firm or the environment in which it operates, will affect the embeddedness of an MNE in a location, since the bargaining power of the MNE in relation to the host government weakens over time (Vernon 1971). However, Kobrin (1987) argued that an MNE's position in a location may not necessarily obsolesce over time, but was dependent on contextual factors such as the type of industry it is involved in, the environment in which it operates and the degree to which the MNE was internally or externally oriented.

The provision of 'after-care' services by agencies, such as IIPAs, is indicative of institutional support and the desire of national and sub-national governments to 'lock in' and embed, over time, existing MNE subsidiary operations within their location (Fuller and Phelps 2004). Mudambi (1998) argued that MNEs' continued investment in a location is likely to depend upon the experience and longevity of operations they have had in that location. The longer a subsidiary has been in a location, the greater the likelihood that it would engage in repeat investment. Therefore, it is incumbent on IIPAs to dedicate the time, effort and resources to uphold and preserve the goodwill of the established subsidiaries that have a history within their domain (Mudambi 1998).

In light of the above discussion, hypothesis three contends that:

H3: *'After-care' service provision will be positively associated with repeat investment in older subsidiaries compared to more recently established ones.*

Method

Sampling and Data Collection

The data used in this chapter were derived from a larger data set that investigated the attitude of foreign subsidiaries to the location advantages found in Australia and the likelihood of these firms engaging repeat investment. Participants in the study consisted of managers of foreign MNEs subsidiaries from North America, Europe and Japan, with established subsidiary operations in Australia. In 2004, over 2200 questionnaires were distributed to foreign MNEs located in Australia. This resulted in 1964 eligible respondents from which 356 questionnaires were returned leading to a response rate of 18.1%. In a review of such studies, Harzing (2000) found that response rates typically varied between 6 and 16%. Non-response bias was checked by examining the firm-level attributes of the sample vis-à-vis the industry and location within Australia, and results revealed no statistical differences between responding and non-responding companies.

Measures

Independent Variable

The independent variables were determined through the conduct of a principal axis factor analysis with oblique (promax) rotation. This principal axis factoring, which also incorporated the use of the pairwise deletion method for missing data, was conducted on the set of 50 items in Part One of the questionnaire. The underlying relationships among all the 50 items were examined as the environment under analysis could not be considered mutually exclusive in terms of the national or sub-national context. The responses were assessed using a 5-point Likert scale with scores ranging from 1 = strongly disagree to 5 = strongly agree, with 3 being the neutral midpoint. Both the Kaiser criterion computation of eigenvalues and an examination of the scree plot supported a ten-factor solution. These ten factors explained 50.2% of the observed variance. In terms of internal consistency, six factors had an acceptable Cronbach alpha score above 0.7, whilst two factors had an alpha score higher than 0.6, deemed acceptable for newly formed scales (Nunnally 1978). Two factors with an alpha coefficient of below 0.6 were dropped leaving eight factors which were usable and interpretable. These factors were labelled and identified as *agglomeration, infrastructure, 'after-care' service, location image,* *institutional environment, labour and other input costs, bureaucratic costs* and *Australian market potential.* The items that captured the *'after-care service'* factor (and their respective communalities) are shown below. The four items loaded on to one factor and had a Cronbach alpha score of 0.79.

The State/Regional Investment agency has had a positive impact on your firm 0.78
The state/local government provides a high level of post-investment support 0.70
The national investment agency 'Invest Australia' has had a positive impact on your firm 0.67
The Australian Government provides a high level of support post-investment 0.51

Dependent Variable

Repeat investment was measured with the following two items shown below, with their respective communalities. The two items loaded on to one factor and had a Cronbach alpha score of 0.9. Following the determination of factor reliabilities, composite scores were created for the factors. Loaded item scores were then averaged on each of the identified factors.

Does your company intend to invest in Australia in the next five years? 0.98
Does your company intend to invest in your present city, regional or rural location, in the next five years? 0.83

It is argued that indications of intention to engage in future investment can overcome difficulties in obtaining actual figures for repeat or re-investments from subsidiary managers. Indications of intention are well established in the literature to be an excellent predictor of actual behaviour (Fishbein and Ajzen 1975).

Analysis of Data

In order to obtain unique estimates of the influence of '*after-care' service* on *repeat investment*, a multiple regression analysis was used to address all the hypotheses. For hypotheses two and three, the analysis considered the interactive effects of the respective contextual variables, the size of the subsidiary and the age of the subsidiary on the relationship specified in the regression model between *'after-care' service* and *repeat investment*, the results of which are shown in Table 4.3. Location- and firm-specific factors that have been shown in the international business literature to affect the investment location decision (Ulgado 1997) were controlled for in the multiple regression analysis. The geographic origin of the subsidiary's parent (Chernotsky 1983; Ulgado 1996; Ulgado and Lee 2004), the sub-location (state) (Dunning 1998; Woodward 1992), the industry (Glickman and Woodward 1988; Porter 1990), the size (Vachani 2005) and the age (Autio et al. 2000) of the subsidiary have all been argued to affect the investment location decision. Firm size was measured through the employee count in the subsidiary (Geringer et al. 2000), and the firm's age was based on the years of operation by the subsidiary in the location. However, owing to positive skewness in firm age, the variable was log transformed (Tabachnick and Fidell 2007).

Dummy variables were created and coded for the main geographic regions of the responding subsidiaries, that is, North America, Europe and Japan. Japan was excluded from the multiple regression models as it was used as the base variable. Similarly for industry type, four variables were dummy coded: primary, manufacturing, wholesale/retail and services. Manufacturing was used as the base variable. For sub-location, states in Australia were dummy coded—New South Wales (NSW), Victoria and Other States, with NSW being used as the base variable.

Results

Characteristics of the Sample

Table 4.1 shows the characteristics of the sample of responding subsidiaries.

An examination of the summary statistics and correlations in Table 4.2 reveals that '*after-care*' *service* with a mean score of 2.5 was rated below the midpoint (3), suggesting a relatively low perception among foreign subsidiaries operating in Australia of the 'after-care' service provision by Australian governments and their IIPAs. However, *repeat investment* (M = 3.3 out of a possible score of 4) was rated positively. Table 4.2 also presents the correlations between the identified factors. The correlations marked with asterisks indicate a significant relationship between the relevant two factors. The correlation matrix reveals that the overall magnitude of the inter-correlations evident in Table 4.2 is not likely to be of concern with regard to multicollinearity.

Table 4.1 Frequencies and percentages of the characteristics of MNE subsidiary respondents ($N = 356$)

	f	%
Geographic origin of the subsidiary		
North America	124	34.8
Europe	120	33.7
Japan	112	31.5
Industry		
Primary	38	10.7
Manufacturing	98	27.5
Wholesale/retail	117	32.9
Services	103	28.9
Years of operation in Australia		
1–10	109	30.6
11–20	106	29.8
21+	131	36.8
No response	10	2.8
Size of subsidiary (no. of employees)		
1–20	107	30.1
21–200	186	52.2
201+	63	17.7
State located		
NSW	194	54.5
Victoria	113	31.7
Other	49	13.8

Correlations in the data set are also large enough as to not threaten discriminant validity (Tabachnick and Fidell 2007).

The regression model in Table 4.3 indicates that '*after-care' service* was found not to be statistically significant in predicting *repeat investment* in Australia and thus resulting in the rejection of hypothesis one. However, the results suggest acceptance for hypothesis two, which predicted that *'after-care' service* will be more significant in predicting *repeat investment* in larger firms ($\beta = 0.38$). Similarly, hypothesis three was also accepted predicting that *'after-care' service* provision will be more significant in predicting *repeat investment* in older more established subsidiaries ($\beta = 0.22$).

Discussion of the Results

This study contributes to a greater understanding of the provision of 'after-care' service and its effect on repeat investment. Birkinshaw and Hood (1997) and UNCTAD (2007) found an increasing importance of the role of IIPAs whose brief extends beyond the attraction of greenfield investments to incor-

Table 4.2 Means, standard deviations and correlations among the measures of variables

Factor	*M*	SD	1	2	3	4	5	6	7	8	9	10
1. 'After-care' service	2.50	0.66	–									
2. Repeat investment	3.30	0.66	0.08	–								
3. North America	0.34	0.48	−0.10	−0.06	–							
4. Europe	0.33	0.47	−0.11*	0.10	−0.52**	–						
5. Primary industry	0.10	0.31	−0.03	0.05	−0.08	−0.05	–					
6. Wholesale/ retail	0.32	0.47	−0.09	0.09	−0.14*	0.10	−0.24**	–				
7. Services	0.29	0.45	0.15**	0.04	0.09	−0.02	−0.22**	−0.45**	–			
8. Victoria	0.32	0.47	0.00	−0.08	0.06	0.04	−0.18**	0.02	−0.10	–		
9. other state	0.14	0.34	0.06	0.15**	−0.04	−0.13*	0.28**	−0.14**	0.00	−0.27**	–	
10. Size of firm	2.30	1.2	−0.06	−0.10	0.11*	0.01	−0.15**	−0.02	0.01	0.02	−0.04	–
11. Age of firm	1.16	0.41	0.08	−0.10	−0.06	−0.02	0.02	0.04	−0.16**	0.02	−0.01	0.22**

$*p < 0.05$, $**p < 0.01$

Table 4.3 Multiple regression analysis—'after-care' service and repeat investment

	Repeat investment (beta weight)						
		Size of MNE subsidiary			Years in Australia		
Variables	Australia	1–20	21–200	200>	1–10	11–20	21>
Independent variable							
'After-care' service	0.05	0.10	–0.02	0.38**	0.03	–0.04	0.22*
Control variables							
Size of the firm	–0.09				–0.22*	0.09	–0.02
Years in Australia	0.08	–0.01	–0.09	–0.02			
Primary industry	0.01	0.06	0.18	–0.15	–0.05	0.10	0.24*
Wholesale/retail	0.13	0.10	0.29*	0.05	0.04	0.22	0.25*
Service industry	0.05	0.05	0.20*	–0.07	–0.14	0.23	0.22*
North America	–0.04	0.05	0.19*	–0.18	0.20	0.01	0.04
Europe	0.06	0.22	0.20*	–0.15	0.25	0.18	0.11
Victoria	0.04	0.05	–0.03	–0.05	–0.06	0.07	0.00
Other state	0.12*	0.17	0.13	0.17	0.16	0.10	0.23*
R(sq)		0.06	0.13	0.26	0.13	0.08	0.19
Error *df*	348	95	168	47	94	95	119

*$p < 0.05$, **$p < 0.01$

porate the maintenance and encouragement of established subsidiaries to increase their investment. The role of IIPAs has also been highlighted in terms of the provision of the 'after-care' service they offer subsidiaries (Site Selection Magazine 2015; UNCTAD 2007). Host governments either directly or through their IIPAs provide post-investment support often in the belief that they can influence further development and embeddedness of MNE subsidiaries in their locations (Fuller and Phelps 2004; Phelps et al. 2003). The current study is important because it provides empirical evidence of the provision of 'after-care' service by Australian governments and their IIPAs. Information generated from studies like this enables the formulation of public policy initiatives with the intention of encouraging the retention of foreign subsidiaries within locations, which in turn helps stimulate the overall economic welfare of the region.

The results of this study suggest that both larger established foreign subsidiaries and older ones are more likely to be able to garner 'after-care' service and potentially ongoing government support for their continued investment in Australia compared to smaller or more recently established subsidiaries. Theoretically, the results support the RBV of the firm (Barney 1991; Penrose 1959), which argues that larger firms are likely to have more resources available to them and can exploit their size to gain more resources. According to Dhanaraj and Beamish (2003), firm size indicates the size of the organizational, managerial and financial resources that a firm has at its disposal.

It logically follows that 'after-care' service in Australia is most likely to be obtained by larger subsidiaries. Such subsidiaries, due to their size, are able to exert more influence and often have the 'ear' of government in looking to garner support for their operations in comparison to smaller firms.

Inferences drawn from the results of the current study suggest that governments in Australia may have come to rely more upon the presence of the large foreign firms within their domains. The perception that larger companies are more likely to provide employment and development opportunities for a region, including the potential of upgrading subsidiary operations, suggests ongoing government and IIPA support for larger firms and their concerted effort to keep them committed to their location. This can be seen practically in the provision of 'after-care' service and support afforded to large high-profile employers such as the foreign car manufacturers in Australia over the last 60 years (Tay 2013). Although 'location' does have a 'used by date', with locational advantages having to evolve in terms of 'after-care' service provision to support ongoing repeat investment from larger MNE players (Cavanagh and Freeman 2012), the importance of 'after-care' service is well understood by its providers in Australia. Invest Australia suggested that 'effective after-care plays a significant role in securing this additional investment where it is locationally mobile' (Invest Australia 2002, p. 10).

However, the results of this study indicate that the IIPA and government focus in terms of the provision of 'after-care' service is concentrated on larger and older foreign subsidiaries operating in Australia. The findings suggest that effective 'after-care' service provision is not being provided to SMEs and 'younger' foreign subsidiaries. The reason(s) for this lack of 'after-care' service provision to SMEs and younger foreign subsidiaries in Australia is open to conjecture, but some of the potential factors are discussed below.

A lack of awareness of the 'after-care' service provided by IIPAs in Australia may exist. It may be that foreign subsidiaries assume that the IIPAs are more concerned with the attraction of the initial investment and not in maintaining and supporting subsequent investment from established operations. This may mean that IIPAs need to develop a higher profile, including the dissemination of information through advertising to increase awareness about the 'after-care' services they provide in supporting and facilitating ongoing investment by established foreign subsidiary operations.

The results also potentially suggest a 'one size fits all' strategy (Bristow 2005) that is focused on the larger and older foreign subsidiaries operating in Australia. This calls for the strategies around the provision of 'after-care' service by the IIPAs to be made more context specific to take into account the needs of smaller and more recently established foreign firms. A greater focus on the development of specific policies and strategy that address the 'after-care' service needs of 'younger' subsidiaries and SMEs operating in Australia is required by IIPAs. An informed discrimination investment strategy (Raines 2003) is required to help promote specific industries in locations throughout Australia by identifying key player companies, whether large or small, young or old. IIPA strategies that concentrate on these 'younger' firms and SMEs through targeted 'after-care' service provision may not only help embed these companies into their locations but also provide the necessary support for future upgrades of subsidiary operations, thus adding to the overall strength and competitive advantage of the location.

Whilst a policy of discrimination in the provision of 'after-care' service is important, it is also critical that the governments in Australia and their IIPAs find a balance between concentrating on a few key 'larger and older players' and avoiding putting 'all their eggs in one basket' when it comes to 'after-care' service support. This becomes critical when a 'key player' divests from a location. There is a need for the government and their IIPAs to spread their resources and provide 'after-care' service support to maintain and embed a broad range of investors within their locations and avoid the potential economic collapse of a region by the withdrawal of a key investor (Lovering 2003). For example, the announcement of the withdrawal of the automotive manufacturing sector in Australia is having just this effect on the states of South Australia and Victoria (Ferguson 2016). Therefore, governments and their IIPAs in developed economies like Australia need to demonstrate greater awareness of the potential consequences, for their locations, of concentrating ongoing support to key 'high-profile' foreign subsidiaries to the detriment of smaller and less well-known and newer foreign MNEs.

Limitations and Avenues for Future Research

The present study results need to be treated (or generalized) with caution and applied advisedly only to other mature and developed economies. The study's use of the proxy measure, repeat investment intention, is another limitation, as it is only indicative of actual repeat investment behaviour. As earlier noted, intention has been found to be a good predictor of actual behaviour (Fishbein and Ajzen 1975), hence the decision to measure repeat investment, by questioning foreign subsidiary managers about their future intentions. However, asking subsidiary managers about future investment intentions may be problematic as it begs the question of whether the subsidiary manager necessarily knows the intentions and plans of MNE headquarters. That said, the growing 'interdependence' in the relationship between affiliates and headquarters (Birkinshaw and Hood 1997; Delany 1998) suggests that subsidiary managers would be aware of future plans for their subsidiary, enabling them to be in a position to know and comment on future investment intentions.

One avenue for future research is the adoption of a more qualitative approach to data collection in order to better understand the experiences of individual subsidiaries regarding their dealings with Australian governments and their IIPAs. By interviewing subsidiary managers, government officials, and IIPA officers, researchers would be able to acquire a more detailed knowledge often not detectable via quantitative data collection in terms of the actual workings of the IIPAs and how they go about the provision of 'after-care' services.

What is evident from the current study is that a better understanding of the impact of 'after-care service' support is important in maintaining a sustained contribution by established foreign investors. Australian governments, including the States, need to provide for a more nuanced focus in their delivery of 'after-care' service to SMEs and younger, more recently established foreign firms. Despite a focused and greater resource allocation to the attraction of new investments, IIPAs in general need to rethink and recalibrate the balance between attracting new investment and winning and sustaining repeat investment. This is because winning repeat investment through the provision of 'after-care' services has been found to be more cost effective than attracting new investment (UNCTAD 2007). Therefore, it makes economic sense that IIPAs develop appropriate strategies and devote necessary resources to provide targeted 'after-care' service to the specific types of foreign subsidiaries that are likely to ensure maximum economic benefit to their location. This is especially important in a global environment in which countries, regions and cities are competing amongst one another to attract foreign investors, by looking to 'poach' established foreign operations from other locations into their own.

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Part II

Emerging Market Frontiers

5

The Growth of Chinese Multinationals: A Micro–Macro, FSA–CSA Framework

Yuxuan Tang and Robert Pearce

Introduction

The fast growth, extensive presence and sometimes contentious positioning of Chinese and other emerging market multinational enterprises (EM-MNEs) provide the most challenging current frontier in our, ever-evolving, understanding of international business (IB) and its role in the global economy. Here, we will see that these 'new' MNEs have the potential to breach the, apparently relatively settled, frontiers of IB at both the practical and theoretical levels. The now quite familiar challenge to established modes of *theorising* in IB is that these new MNEs are emerging at a much earlier stage in the competitive formulation of their home country and, clearly related to this, long before such firms would have logically been expected to have achieved the levels of international competitiveness required by such traditional analysis. The pertinent question here is 'how' these firms are able to become MNEs under these conditions. From this background, the challenge of these new MNEs to the accepted modes of *practice* in IB can directly reflect these idiosyncratic (or unprecedented) origins. They often enter the global market environment on the basis of rather different sources of competitive advantage and do so in order to pursue somewhat differently focused strategic objectives. This, we will elaborate, in effect poses the question as to 'why' these firms internationalize when and how they do and the precise sources of their impetus to do so.

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To address these issues and understand the origins of EM-MNEs, our central thesis will be that it is necessary to see the early internationalization of these firms as being responsive to, and conditioned by, tensions and imperatives that emerge within the development of their home countries, with China being the exemplifying case. In essence, we will argue that there is a macro-level element (the capacities and imbalances of *home*-country development) that determines the micro-level emergence of such EM-MNEs that was absent from the systemic and institutional context for the earlier generations of 'Western' MNEs. In the next section, we begin this process by drawing out precise ways in which the current emergence of EM-MNEs contrasts with expectations derived from the earlier MNEs and appears to challenge the IB theorising that was built from them. Comprehending this mismatch not only allows us to clarify the agenda to be addressed by our EM-MNE framework but, ultimately, also shows how this can still be most effectively constructed from essential tenets learnt from the history of IB. In fact, central to this will be two more recent analytical topics that appeared within mainstream IB thinking to address changes in the context within which traditional MNEs found themselves operating. Firstly, the growing importance of broadly defined 'institutions' in conditioning the behavioural environment faced by these enterprises. Secondly, the need to develop 'relational' expertise as MNEs moved into a wider range of organisational contexts, accepting the importance of contractual agreements and alliances.

From 'Traditional' Western to 'New' Emerging Economy MNEs

In this section we initially introduce aspects of the pioneering analyses of IB which served to provide us with crucial perceptions of the origins and nature of the traditional MNEs. These provide analytical templates from which we can discern the ways in which the new EM-MNEs challenge established perceptions and then build the foundations from which we seek to derive our refocused framework. We can now see the essence of the current fully evolved version of the traditional MNE as a firm that seeks to leverage the differences between locations into an overall global competitive strategy (Pearce 2006). This aims to cover the two overarching objectives of any strategically mature enterprise. Firstly, to secure optimal performance (profit, growth and market share) benefits from its in-place mature sources of competitiveness, that is, exploitation. Secondly, to seek to access appropriate means of reinforcing and refocusing these sources of core competitiveness, that is, exploration for augmentation. The early attempts to model the MNE as an established entity focused predominantly on its approach to the first of these objectives, with the analysis primarily concerned with the static and optimising aim of the efficient use of its established capabilities and resources. Here, these mature and fully understood sources of firm-level competitiveness were seen as being applied in diverse locations in order to benefit from either their inputs to production (efficiency seeking—ES) or market potentials (market seeking—MS). Here, we will follow the development of this framework forward as it came to encompass more dynamic and evolutionary perspectives, and the embracing of a wider range of strategic objectives within the MNEs' internationalization and, increasingly, their responses to institutional contingencies. The emergence of these issues and contexts in the traditional MNEs, we argue, will help us to elucidate the idiosyncrasies, but ultimately the coherence, of the new MNEs.

It has proved conventional in building frameworks to analyze MNEs, whether traditional Western or new emerging economy, to begin with the sources of firm-level ability to achieve effective international expansion. This has been designated as ownership advantage (OA) in the eclectic framework (Dunning 1977, 1988; Dunning and Lundan 2008a) or as firm-specific advantages in the firm-specific advantage/country-specific advantage (FSA/CSA) matrix (Rugman 1981; Rugman and Verbeke 2009; Rugman et al. 2011). Two important lines of argument underpinned this in the early theorising. The first is that these OA/FSA will have been generated entirely in the MNE's home-country operations. Of course, the *initial* extension of a firm's operations into foreign operations can logically *only* have derived from home-country activities. Indeed, this insight had preceded substantive attempts at analysis of the MNE per se, being central to the first stage (product development/innovation) of Vernon's (1966) product life-cycle model. Thus Vernon, then in pursuit of rather different analytical objectives, provided a persuasive and detailed explanation of how a firm that initially had no international ambitions or perspectives could, through a process of innovation that entirely reflected its 'domestic' needs and potentials, create those sources of distinctive competitiveness that could lead it, somewhat serendipitously, into the international expansions that could presage its accession into the fully evolved and strategically diverse 'traditional' MNE.

Secondly, the fact that key competitive characteristics of these proto-MNEs would reflect home-country conditions (influential market needs and practices, technological capacities, social factors that would determine managerial and employment practices and other distinctive influences of the institutional environment) means that their transposition into foreign operations could prove problematic. Thus many such conditions, to which the firm's OA/FSA had developed responsively, would differ in those foreign economies where other competitive factors would be suggesting the relocation of value-adding activities. There would be an innate 'liability of foreignness' (Hymer 1960/1976; Zaheer 1995) that would place the MNE at a disadvantage when seeking to compete with securely embedded local enterprises. The home-country-derived sources of unique firm-level competitiveness would need to not only differentiate their offering from other firms, but do so to a degree that could overcome those cost-advantages that entrenched domestic firms would derive merely from their operative familiarity with those environmental and institutional characteristics that would challenge the new foreign entrants.

The scenario implied by these foundation texts of IB theorising, therefore, presumed that national firms would have only been able to formulate these decisively strong sources of international competitiveness over quite long periods of time during which their own evolution would have been embedded in the gradualist processes of their own country's industrialisation and technological deepening. The expectation was then that MNEs could only emerge from a limited group of high-income and technologically advanced economies with fully evolved industrial sectors where business normally operated at arms-length from any significant degree of routine government intervention.[1] Linked to this was the further expectation that, due to the qualitative characteristics of the products involved and the input needs of their manufacture, the first foreign markets entered by the exploratory MNEs would be those of very similar advanced economies. The market-seeking objectives underlying this were clearly articulated in the second (mature product) stage of Vernon's product life-cycle model (1966). A little later, the Uppsala model of MNE expansion (Johanson and Vahlne 1977, 1990) also placed emphasis on such firms pursuing their pioneering overseas entry into economies that possessed similar economic and institutional conditions.[2] The ways in which the pioneering internationalization of the new MNEs from high-growth emerg-

[1] This is not to claim, of course, that developed industrialised economies *never* had policies towards outward foreign direct investment (OFDI). But, as argued in detail by Buckley et al. (2010), these were predominantly articulated as macro-level capital controls and often based on neo-classical frameworks that denied the micro-level understandings of MNEs generated in IB theorising.

[2] Recently, Meyer (2014) has refocused an 'internationalisation process' model towards the specific context of EM-MNEs. Thus the emphasis is placed much more decisively on *institutional*, rather than mainly *economic*, similarities in determining plausible locations for early international expansions. This encompasses experience in operating in (and from) institutionally uncertain and volatile environments. This coalesces with our conceptualisation of *relationship* firm-specific advantages as distinctive attributes of potential EM-MNEs, enabling them to operate flexibly and responsibly within opaque and incoherent institutions of planning and regulation.

ing economies defies these long-established nostrums of IB thinking will be developed systematically here.

Before that we need to take account of important aspects of how the traditional MNEs themselves evolved as they widened their international scopes and objectives and sought to systematically leverage different host-location potentials into broadly based globalised strategic perspectives. In particular, this came to embody not just the 'exploitation' (through MS and/or ES) of the home-country-derived foundation sources of competitiveness, but also their 'augmentation' in decentralised exploratory activities through KS (Pearce 2012; Zhang and Pearce 2012) or strategic asset seeking (Dunning 1993; Dunning and Lundan 2008a).[3] In the main, however, this remained a predominantly gradualist and path-dependent process, where the MNEs expected to generate their revised and revitalised capacities by adding new diversifying capabilities to the knowledge platforms that had underpinned and defined their distinctive established competitiveness. This nevertheless does represent a vital step in the strategic evolution of MNEs and of their organisational structure. Having originally generated their defining OA/FSA at home, and then based their initial international expansion on them, the traditional MNEs gradually break free of exclusive dependence on this one source for competitiveness and begin to address their competitive renewal by leveraging the knowledge and creative heterogeneity of many locations (Papanastassiou and Pearce 2009). This means that, as these traditional MNEs extended their international scope and drew the influence of these dispersed and diverse attributes into their decision making, they became less influenced by the growth patterns, policies and institutions of their home countries. It also meant that eventually the activities of these mature industrial economy MNEs could no longer be interpreted primarily in terms of foreign direct investment (FDI) *by* one country *into* another country.

Thus, once they were substantially globally networked, not only did the *home* country take a less hegemonic status in the traditional MNEs, but also no particular *host* economy would be likely to take on decisive positions of distinctive strategic influence within the drivers of these firms' expansion. Our emphasis on the roles of resource seeking (RS) and knowledge seeking (KS) as drivers in the initial international expansion of Chinese business represents one of the defining differences of these new firms. These, we will argue, do represent specific acts of FDI which place the activating MNE, both directly

[3] These have been manifest in the expansion of decentralised and internationalized RandD programmes in MNEs and its interrelations with globalised approaches to innovation (Papanastassiou and Pearce 2009, Chap. 8).

and indirectly, at the core of important aspects of home-country developmental concerns. Both RS and KS can be seen as often being, indeed, FDI by one country into another reflecting both vulnerabilities in the investing-country's development and very specific strengths of the host country. The choice of host country not only works for the interests of the expanding firm but becomes available to it precisely because it reflects developmental needs of the home country which, therefore, offers specifically tailored support.

To summarize from our understanding of the *emergence* of the early generations of the now well-established traditional MNEs, we make the following points. Firstly, their initial internationalization was based on OA/FSA that had evolved in a rather iterative way within the development of their home country, taking forms needed to be competitive there. Secondly, the decision to commit to international expansion was based on the firm's own perception of opportunities in foreign locations that could be best exploited by the activation of their in-place OA/FSA. These perspectives provide the bases for the comparisons and challenges that need to be addressed in seeking to explain the origins of MNEs from high-growth emerging economies such as China; our analytical focus here. The initial assertion is that such internationalization has been occurring before such firms had plausibly had the opportunity to generate OA/FSA that could facilitate entry into international competitiveness in the traditional fashion, and before their domestic market positioning was provoking reasons for them to need to consider doing so.

As exemplified by China, the high rates of growth that have distinguished the most influential emerging market economies have mainly derived from exceptional exporting performance. This derived from the activation of previously latent sources of comparative advantage (notably low-wage and, therefore, potentially cost-competitive, labour) as the bases of international competitiveness. However, at this very early stage of development, the firms that proved most able to leverage these sources of country-level advantages towards success in international markets tended to be foreign MNEs, or local-enterprise subcontractors to foreign firms that provided the technologies and market access to do so. This also has prominence in early thinking on traditional MNEs, representing the ES behaviour predicted by Vernon for the standardized product stage of the product life-cycle model and also the trade-creating FDI designated by Kojima (1978) as exemplifying the early phase of Japanese MNE expansion. There was nothing in that scenario that immediately required, or provided an impetus for, the generation of MNEs *from* these early growth economies.

The build-up, and prompt internationalization, of certain types of firms within China, we will argue, sought very precisely to overcome emerging short-term vulnerabilities in the established mode of development and then, in the medium term, to secure the means of moving towards a more knowledge-driven model of competitive upgrading and industrialisation. This places the central emphasis of our framework on the origins of Chinese MNEs in playing roles that are in many ways integral to the wider development of the home economy, so that their emergence and objectives will often be mandated and supported by its institutions. The ways these new MNEs enter the global economy and the reasons for their so doing contrast very decisively with the bases of extant thinking on mature traditional MNEs. But, for all their challenging idiosyncrasies, these firms cannot defy the established norms and practices of the institutionally formulated global economy they enter and the constituent national economies that attract them. This means that, precisely because the new MNEs will need to compete and operate alongside traditional MNEs in environments defined over decades by these mature global firms, they have to be explained through the broad perspectives of the extant modes of analysis.

It has also been argued that, because it is unrealistic to believe that many new EM-MNEs have already generated OA/FSA at a level that would allow them to compete on equal terms with traditional MNEs in the established global markets that are their natural territory, the concept is of limited applicability to comprehension of Chinese and other EM-MNEs. We will reject that view here but argue that the competitive competences that are unique to particular EM-MNEs need to be analytically repositioned and understood from within this very different context; in terms of both their origins and operationalisation. Relating to this, we will also adopt and systematically develop another well-established assertion; that these EM-MNEs are able to expand internationally, despite the vulnerability of their FSA, because they can access various types of support from their home country. In effect the sources of competitiveness these firms can activate so as to be able to undertake particular acts of FDI become a composite of their own FSA and supportive elements of home-country-specific advantages. But then the question as to how *particular* firms are able to access these forms of support, from beyond their own already internalised assets and capacities, becomes another element of our framework.

To begin rather conventionally we will first adopt *asset* firm-specific advantages (FSA-A) which represent those knowledge- and skill-based attributes that are central to the distinctive competitiveness of a firm and thereby provide the core of its ability to expand internationally and successfully carry out specific value-adding activities overseas. In the familiar modelling of the traditional MNE it has been assumed that their FSA-A were fully evolved and sufficiently strong so as to not only secure the bases for successful foreign operations but also help to define what the strategic purpose of these operations will be. We have already acknowledged that one defining issue relating to the emerging new MNEs is that their FSA-A will not yet have achieved that status. Yet we believe that they remain a central facet of understanding these firms. Certainly their FSA-A will rarely secure, on their own, immediate *direct* entry into international opportunities. But they are likely to be crucial elements of the *indirect* route to overseas expansion, through the support of home-country resources and development programmes. The ability of, for example, a Chinese firm to project itself as possessing the strongest FSA-A amongst plausible candidates to pursue overseas options that are favoured by the government's own perceived objectives can be vital.

This indirect route to the leveraging of FSA-A as a basis for EM-MNE internationalization derives from the firm's ability to project them into and through the complex institutional bureaucracies of the home-country government. This becomes such an important and contextually distinctive part of the process that we distinguish it as a necessary and separate attribute of EM-MNEs in the form of *relationship* firm-specific advantages (FSA-R). Thus FSA-R represents the firm's ability to build and maintain relationships with those institutions and agencies that may define opportunities and provide resources that can underpin its own internationalization. Though the ability of FSA-R to spin the strength of potentially relevant current FSA-A is clearly vital, the way it projects the firm's overall status and potentials within the power structures of home-country institutions can also have a wider and prolonged relevance. The relevance of FSA-R underlines again that the early emergence of these EM-MNEs is very much integral to the international expansion programmes of their *home* country in a way that would not have been as significant for the traditional Western MNEs, where any such links would have dissolved with these firms' growing range of overseas associations and interdependencies. This latter point does, of course, accept that building relationships within an extensive nexus of networks is an important facet of the international competitive coherence of long-established MNEs. We would see this as, however, a traditional managerial FSA-A, relating to the *tactical* positioning of the firm internal to the routinely evolving contexts of its *industry.* FSA-R aims to secure the firm's status in the *strategic* internationalization of its home *country*. It is to the details of how that home-country development strategy conditions the potentials for the early appearance of EM-MNEs that our framework needs to turn next.

The first element of this is to distinguish *developmental* country-specific advantages (CSA-D) as factors that are integral to the home country's development and which, in some way, can then underpin the *ability* of certain firms to expand internationally and/or provide a *motivation* for them to do so. These different implications for the origination of EM-MNEs derive from both positive and negative aspects of CSA-D. On the positive side, high growth rates generate high levels of savings and foreign exchange which can potentially be accessed by the firms to enable them to undertake particular acts of FDI.[4] On the negative side of CSA-D, we can discern imbalances and vulnerabilities in the sustainability of the successful development processes, the alleviation of which may provide the reason for these acts of FDI. Our later analytical focus on RS and KS, as very distinctive micro-level emphases in the growing internationalization of Chinese business, can exemplify how the overseas operations of such new MNEs can feed back to the alleviation of constraints within the macro-level progress of home economies.

Though the success of many of the high-growth emerging economies has been associated with the introduction of market forces domestically and with an opening to international competition this has normally proceeded within a continuation of *development* programmes that are carefully articulated to pursue the upgrading and reinforcement of competitiveness. The policy bases of this can then reflect both sides of CSA-D and be implemented through a network of institutions whose aims can condition the prospects for potential EM-MNEs. The positive manifestations of success, such as foreign exchange and capital, can be treated as 'policy resources' and *allocated* to purposes that support the reinforcing and refocusing of development processes. Precisely targeted acts of FDI can be central to this and, at the same time, provide a logical impetus to the international expansion of domestic enterprises.

The analytical core of the framework is that the internationalization of many influential EM-MNEs reflects an embedded positioning in the development of their home countries. Their capacity to secure this status reflects their assertion, partially around advocacy of their existing FSA-A, of an ability to fulfil roles defined around precise needs of their domestic economies' development (reflecting negative CSA-D; CSA-D/−) *if* they are provided with necessary supports (positive CSA-D; CSA-D/+). The international expansion of these firms can derive from their perceived ability to operationalize international projects that will meet specific developmental needs of the home economy. Realization of this possibility is very much dependent on a negotiating con-

[4] Aharoni (2014) has drawn attention to similar lines of argument in very early thinking on MNEs. Thus he notes how Aliber (1970, 1971) suggested that a competitive advantage available to an MNE 'was its access to hard currencies and lower financial costs … [so that] one reason why some countries may spawn more MNEs than others is that their firms have access to hard currencies and can use that advantage to acquire other firms in other countries' (Aharoni 2014, p. 24).

text that is likely to involve a range of home-country institutions. From this we derive the importance of *institutional* country-specific advantages (CSA-I), these being the set of institutions that firms seeking to expand internationally will need to negotiate with in order to secure access to the forms of support they need to supplement their FSA-A. It is the very distinctive role of FSA-R to understand and work within these institutional networks and bridge the gaps between the firm's aims and country's developmental needs.

Levels of Developmental Resources and MNE Motivations

As a prelude to a more detailed application of our FSA–CSA framework to the case of China and its emergent MNEs it is useful to adopt a complementary analytical approach which distinguishes three 'levels' of developmental resources and relates them to the varied strategic motivations that can be pursued by MNEs. In its original derivation (Pearce and Zhang 2010; Zhang and Pearce 2012), this approach was initially applied to the case of MNEs' operations *in* China, but here we can adapt it usefully to show how the needs of China's developmental dynamism has focused the expansion of its emergent MNEs around, in particular, RS and KS.

Here, level-1 resources are natural or primary resources in the form of extracted energy and minerals or forestry. A central feature of these resources is that they are either totally non-renewable or can only be renewed over long and uncertain periods of time. Therefore processes of development based around such level-1 resources will be structurally limited and extremely vulnerable in terms of sustainability. Level-1-based development would need to be systematically broadened and diversified, perhaps by localizing further stages in the value chain (processing or refining). Or, alternatively, revenue and foreign exchange generated by early exploitation of these resources could be reinvested in a more generalised progression into manufacturing.

In terms of inward investment level-1 resources have been accessed through the RS strategic motivation.[5] The central role of RS in China's *outward* FDI then derives from a different positioning of level-1 resources; as significant complementary inputs into export-oriented manufacturing processes primarily driven by large supplies of cost-competitive labour. As a possibly general-

[5] Strictly speaking we should here refer to *primary* resource seeking (to parallel level-1 resources), rather than the broader, but simpler resource seeking. Thus our RS excludes, by comparison with Dunning and Lundan (2008a, p. 68), 'cheap and well-motivated unskilled or semi-skilled labour'. This latter becomes a key element of our level-2 resources.

isable rule, it could be suggested that where early stage growth is decisively based around a dominant resource (such as labour) the planning processes may somewhat neglect the significance of relevant secondary resources (such as energy or minerals) until constraining shortages begin to emerge. Thus RS by Chinese MNEs may emerge (ultimately within planning processes) as a means of providing inputs to support the prolongation of the established bases of home-country development.

We can then see the more sustainable forms of national development as being based around level-2 resources, in the form of inputs into mature and successful production processes, which can be upgraded *within* the development process itself. Thus, most prominently, an in-place labour force can be retrained to higher skill levels, whilst new entrants may from the start achieve higher productivity levels that reflect continuing improvements in education standards. Similarly energy supplies, as a level-2 resource,[6] can be improved both in terms of price and reliability. The capacity of many aspects of infrastructure, including transport systems, ports and airports and IT and other communication networks, can be enhanced in ways that support deepening of industrial competitiveness. But the second defining feature of level-2 resources is then that though they are able to play higher-value-added roles they do not, in and of themselves, possess the capacities to create the new technologies they could work with and to thereby define the nature of their upgraded supply responsibilities. For persistent growth the upgrading of level-2 resources is necessary but not sufficient. The limitations of an early growth economy to generate such new opportunities for its own firms to apply level-2 resources more effectively have opened up possibilities for foreign MNEs to access them competitively. This would initially be through MS and ES strategies (Pearce and Zhang 2010). Bearing in mind China's presumed strength in level-2 resources, there had, until quite recently, been analytical scepticism about the scope for MS or ES in its outward FDI. But recent studies of the determinants of Chinese FDI have found positive relationships for variables likely to reflect a MS motivation. A prevalent interpretation of this, however, has been that it represents marketing and distribution activities that mainly aim to enhance the market for Chinese exports. Thus, its driver remains, if indirectly, the *home* country's level-2 resources. Similarly, often anecdotal or case-study evidence (e.g. Shen 2013) does suggest the emergence of ES production in low-cost locations *outside* China. This tends to be in low-technology mass-market consumer goods sectors so that it may be interpreted

[6] We refer here to 'energy' in terms of a national generation and distribution system, which can be improved and upgraded through time; rather than non-renewable fossil-fuel primary sources.

as relocation, by Chinese enterprises in such industries, of supply of goods based around the lower-level level-2 resources that are losing competitiveness and being superseded in China's exporting.

The distinguishing feature of level-3 resources is 'the capacity to contribute to the *local* derivation of new knowledge-driven developmental potentials … [that will] have no association with current supply of standardised goods and services … [but are] the resources that help define *new* directions and opportunities for development' (Pearce and Zhang 2010, p. 490). Level-3 resources thus encompass 'individuals, teams, firms, knowledge-support infrastructures and technology policies' whose 'technology, skills, inventiveness and imagination … will contribute interactively and interdependently to the interjection of creative dynamism into an economy' (Pearce and Zhang 2010, p. 490). The increasingly systematic attempts of host-country governments to provide an institutional context for the creation and operationalization of level-3 resources have been formalised in an extensive literature on national systems of innovation (NSI) (Freeman 1987; Dosi et al. 1988; Edquist 1997; 2005; Nelson 1993; Lundvall 1992, 2007). Since the aim of an NSI is to build new bases for national competitiveness, the most successful will be those that generate the most powerfully distinctive new technology scopes and provide ideas for new goods derived from market research. This has meant that traditional MNEs increasingly found themselves in a global context of technological heterogeneity and market heterogeneity (Papanastassiou and Pearce 2009), as potential inputs to their own innovative programmes. KS, activated through decentralised international networks of R&D labs and innovation-targeting subsidiaries, became the dominant mechanism for these MNEs' own competitive renewal. An effective NSI can attract significant KS commitments in inward FDI.

A growing literature (Liu and White 2001; Lu and Lazonick 2001; Gu and Lundvall 2006; Lazonick 2004; Hu and Mathews 2008; Li 2009; Yang et al. 2012; Franco and Leoncini 2013) now documents the emergence of a very significant NSI in China and the generation of increasing quantities of level-3 resources. In terms of underwriting the evolutionary sustainability of development this can target the need to use the increasingly scarce level-1 resources (a potential developmental bottleneck) as sparingly as possible and to provide new roles for level-2 resources that make logical use of their potentials for upgrading and enhanced productivity. The apparent appearance of KS activities very early in the life of, at least some, Chinese MNEs can then reflect two interrelated factors. Firstly, that the Chinese NSI is emerging earlier in the economy's growth than traditional expectations would have anticipated and, therefore, its augmentation through access to more fully evolved NSI elsewhere may be logical. Secondly, in line with our perception of technological and market heterogeneity, it would be expected that firms from any economy targeting a logical range of creative (level-3) resources would need to implement selective KS operations in other economies. In a sense that would be less true for KS operations in fully globalised traditional MNEs from countries with mature NSI, we will argue that the KS of new Chinese MNEs represents an element of internationalization of the Chinese NSI itself.

Firm-Specific and Country-Specific Factors in the Growth of Chinese Multinationals

Central to the challenging context of Chinese MNEs are the twin features of the *international* economy that they will enter and the *national* economy that conditions their initial formulation as firms. Our characterisation of the 'traditional' MNEs indicated that they were fully evolved firms from institutionally settled domestic economies that eventually pioneered speculative entry into a then much less open or integrated global economy. Our interpretation places the new Chinese MNEs in somewhat the opposite position; as firms that are themselves still in the process of defining and understanding their competitive nature that nevertheless find reasons to venture into a highly competitive and open international economy in which the mature traditional MNEs now have long-established roots. The challenge and aim of our framework is to address in tandem the *micro*-level issues of the formulation and very early internationalization of Chinese MNEs as *firms* and the *macro*-level context we find for them as significantly embedded players in Chinese *developmental* needs and progress.

Asset Firm-Specific Advantages (FSA-A)

We define FSA-A as the 'unique attributes of a firm that relate directly to its capacity to undertake specific value-adding activities in a competitive manner and which can be activated effectively when that firm wishes to expand internationally so as to benefit from a clearly perceived opportunity'. Central to these are intangible competitive competences such as 'technology and information, managerial, marketing and entrepreneurial skills [and] organisational systems' (Dunning and Lundan 2008a, p. 96) that have been positioned in recent forms of the eclectic framework as asset-specific OA. We retain the importance of FSA-A as the central micro-level influence on Chinese MNEs because of its ability to assert these firms' status in two contexts. Firstly, the conventional and traditional firm- and industry-level scenario in which its FSA-A would provide the defining ability of the firm to enter competitively into an available overseas project or newly perceived opportunity. Here, the FSA-A needs to be exercised relative to the comparable competences of other possible international aspirants to the same opportunity. Secondly, the domestic institutional context from which the putative Chinese MNE will seek to access various types of desired home-country support. Since we expect this governmental institutional support to be initially related to the perceived desirability of the external project itself, rather than to any a priori commitment to a specific firm, it becomes logical that the suitability of the FSA-A that the aspirant MNE can advocate (relative to those of other Chinese enterprises) remains a key attribute.[7]

It is the first of these two contexts that has so far had most traction in thinking about FSA-A in Chinese MNEs. This stems from the suggestion that at such an early stage of their home country's industrialisation they will be less than fully realized and that this will logically compromise their capacity to compete with comparable attributes of long-established and internationally attuned 'traditional' rivals. Here it is useful to elaborate the specifics of this assertion in the two CSA-D drivers we focus on: the RS/infrastructure provision case and that of KS. An influential aspect of these cases is the very different status of the host countries that provide these opportunities and the potential positioning of the Chinese MNE investment. The presence of 'exploitable' RS potentials, as level-1 resources, often implies an early stage of host-country development, so that the frequent complementary offer of infrastructure creation or improvement (a level-2 developmental resource) also becomes part of a Chinese package. China offers these resources (CSA-D as well as FSA-A) from a more developed status, but also as a means of sustaining its growth. For KS investments, seeking host-country level-3 resources, the investment is made from a lower level of industrial development; it is to 'augment' the current FSA-A that the investment is pursued.

The most contentious and pervasive context for China's RS has become that of 'South–South' investments (notably into Africa). This is likely to impose important institutional and diplomatic influences on decision making since it becomes integral to both countries' developmental needs. It also provides significant nuances to the interpretation of FSA-A of potential Chinese par-

[7] Where EM-MNEs have genuine FSA-A likely to contribute positively to host-country development they may face less resistance than where there is a clear perception of their dependence on home-country CSA-D support mediated by home-country CSA-I.

ticipants.[8] One aspect of this is the presumption that much of this resource development/exploitation will be carried out by foreign enterprises at the pioneering stages. This means that the primary competitors faced by Chinese enterprises to initiate such projects will be from developed industrial economies. Here, the Chinese FSA-A may indeed fall short of the 'state-of-the-art' competences of competitively mature developed country rivals, but may perhaps be more appropriate to realization of the developing country project's potentials.

One aspect of this may relate to the ability to create and secure the initial provision of infrastructure capacity and services which are often leveraged as part of a RS package. Expertise with regard to this will have been recently learned at home by potential Chinese infrastructure MNEs and take forms more suitable to the similarly early stages of creating these foundations of sustainable growth and development in resource rich countries. Another possibility here is that Chinese RS and infrastructure-creation firms will have emerged within the institutions of China's own early stage development and will have developed an expertise (our FSA-R) in negotiating and positioning their own status within such a complex, uncertain and evolving context. As, to some degree, a managerial facet of FSA-A this type of expertise may provide these Chinese MNEs with a superior ability, compared to developed economy rivals from more institutionally neutral backgrounds, to secure their position in the developing country projects. Even where not perceived as against possible local rivals external entrants to these often institutionally complex and perhaps volatile environments will still face strong 'liabilities of foreignness'. These may be less alienating to Chinese firms, from a similar home-country background, which will also have a distinct FSA (whether categorised here as 'A' or 'R') in dealing with them (Cuervo-Cazurra and Genc 2008).

The now quite familiar paradox of FSA-A in the case of KS by Chinese MNEs is that it is motivated by their perceived weakness and yet dependent on them to secure entry into possible external learning opportunities. Both of the contexts in which we suggest that FSA-A need to be exercised by Chinese MNEs in securing international expansion can be distinguished in the case of investments motivated by KS factors. Firstly, in terms of the direct firm-level context, the firm's current knowledge-based FSA will determine which external opportunities it feels it needs to pursue. These will logically be ones that

[8] Some of the lines of argument developed here in relation to 'South–South' RS investments may be transferable to the emerging stages of Chinese MS and ES in Africa and other developing countries. For instance goods and services created to be competitive in the Chinese market (including the ability to produce them cheaply) through the early stages of its development may transfer logically and effectively into competitiveness in other emerging markets.

can add coherent new dimensions to the extant competences so as to enhance technological competitiveness in an evolutionary manner. The current FSA-A will provide the basis for understanding and evaluating such learning prospects, and for their subsequent assimilation and operationalization as sensible directions for competitive upgrading. But, in the logic of mainstream IB theorising, these current FSA-A, because of their accepted limitations, cannot by themselves secure access to the desired new knowledge potentials. They need the home-country support of the second context to allow for this. Here, it should be the firm's appreciation of its current FSA-A and the ability to articulate the precise limitations that they aim to overcome through the KS-investment opportunity which they seek to spin to an informed, institutional selection process that may provide the needed support. The aim would be to project to the decision makers that these FSA-A could provide the basis for their ability to secure new knowledge-based capacities that both enhance the firm's own competitiveness and do so in ways that can feed back into the provision of new scopes in the Chinese NSI and, therefore, add to its capacity to widen the range of level-3 resources driving its progress.[9]

Relationship Firm-Specific Advantages (FSA-R)

We consider FSA-R to be 'a firm's managerial abilities to establish, nurture and draw benefits from external relationships, through which they seek to secure preferred access to what are, at least initially, generally available sources of support'. Similarly, Dunning (2002) defines firm-specific relational assets as 'the stock of a firm's willingness and capability to access, shape and engage in economically beneficial relationships; and to sustain and upgrade these relationships'.[10] Regarding possible 'special ownership advantages of Chinese MNEs' Buckley et al. (2007, p. 502) indicate 'the ability to engage in beneficial relations with firms and other actors to provide access to resources

[9] This positions these early KS investments of Chinese MNEs in two analytical contexts. Firstly, in line with now-established understanding of KS in the mature 'traditional' MNEs, it may generate new firm-level attributes that can be applied anywhere in an expanding and diversifying MNE's global operations (multidirectional technology transfers), that is, non-location-bound subsidiary-specific advantages (Rugman and Verbeke 2001). But in the EM-MNE case it may more resemble the, now mainly superseded, concept of 'reverse technology transfer' in which a prioritised flow of new technology and similarly competitive attributes goes from an overseas facility specifically back to the parent and home-country operations.

[10] In later work Dunning subsumed his insights on relationship building and relationship assets into the new concept of institutional ownership advantage (OA_i) (Dunning and Lundan 2008b; Lundan 2010).

controlled by others'.[11] Similarly, Buckley et al. (2011, p. 135) suggest that 'economic systems which are built upon "relation-based" governance systems may reward personal linkages between business and governments'. In our framework FSA-R are applied by putative Chinese MNEs to access supporting aspects of CSA-D through an ability to operate within the appropriate institutional environments (CSA-I).[12] Thus Peng et al. (2005, p. 623) defined institutional relatedness 'as the degree of informal embeddedness or interconnectedness with dominant institutions [which] confers resources and increases the legitimacy of an organisation' and builds ties with 'a dense network … of dominant institutions'.

Firms that have emerged in countries such as China, will have done so during periods of not only high levels of *economic* growth and change, but also when significant elements of the *institutional* environment (emerging CSA-I) will have been subject to formulation and reformulation. Thus they will have learnt, as a central element of FSA-R, to understand, tolerate and derive flexibility as a response to, such institutional volatility and endemic change. In terms of our wider analytical context, we can then argue that such an ability to work within institutional change through *time* in the home-country environment can also become a significant attribute in adjusting to environmental and institutional differences across *space*. Firm-level expertise derived from processes of continual adjustment to institutional change within China can also be leveraged within the comparable process of entry into somewhat different overseas contexts. In this way FSA-R may provide Chinese MNEs with capacities that are useful in dealing with the liability of foreignness and which might not be available in comparable forms to MNEs that come from relatively stable and consistently formulated backgrounds.[13]

A justly pervasive distinction often included in analysis of China's MNEs (Wang et al. 2012a, b; Cui and Jiang 2012; Duanmu 2012; Alon 2010; Luo and Tung 2007; Lu et al. 2014; Meyer et al. 2014) is that between state-owned and private enterprises (SOE and PE). The logical expectation here

[11] Rugman (2010, p. 84) suggests 'MNEs from emerging markets [need] to develop FSA-A in business-government relations'.

[12] In an analysis of the determinants of Chinese outward FDI Wang et al. (2012a, p. 672) argue that firm-level resources (our FSA-A) only trigger foreign expansion 'when firms are strongly supported by government', so that an emerging economy MNE's 'ability to employ its resources and internationalize depends on its effectiveness in managing government ties' (our FSA-R).

[13] Of course the extent to which FSA-R learnt in a home-country context can transfer to building relationships with host countries' agencies and policy makers is uncertain. In fact, differences in the types of FSA-R that are most viable for effective positioning in terms of home- and host-country institutions will be a significant influence in determining the extent and implications of the cultural and institutional *distance* often modelled into analysis of determinants of FDI.

would then be that by their very institutional nature SOEs would be more embedded in relevant CSA-I and have more direct access to the resources and motivation defined by CSA-D. This does not mean that FSA-R are likely to become less relevant as firm-level competitive attributes in SOEs seeking to internationalize. Even where projects might be initially institutionally defined to play a specific role defined within China's developmental needs (notably in RS cases), with SOE participation preferred, firm-level determinants should still have important influences. Firstly, where several SOE are plausible candidates to implement such a project their relative FSA-R will play their normal role. Secondly, however a SOE achieves selection for a particular CSA-D project, it will then seek to individualize its development in ways that will allow it to apply its FSA-A capacities in the strongest way possible. Asserting this in the planning/bargaining process with, in effect, commissioning government agencies will again be facilitated through its FSA-R. Finally, there will be many sectors (particularly those with strategic emphasis on KS) where both SOE and PE are aspirant MNEs and would take responsibility for asserting the presence of worthy FDI opportunities and seek support for them through their FSA-R. It may then become an important normative or efficiency issue as to whether SOEs can assert stronger FSA-R in such cases. This could reflect an innate preference of governmental institutions for SOEs per se or that these enterprises would often have stronger, or at least more relevant, FSA-R simply as a result of the experience of being embedded in such institutional contexts.[14]

In terms of *normative* concerns issues emerge with regard to how the relationship between their FSA-A and FSA-R affect efficiency in the realization of the true economic potentials of a project/investment these EM-MNEs enter into. This is, of course, especially important to a host country, either in terms of securing the developmental potential of its resource base, for a RS investment, or in terms of achieving the most valuable realization of creative potentials in its knowledge base and NSI in the case of KS. Here a potential *complementary* relationship would prevail if very strong FSA-R operated to make sure that a project was implemented by the Chinese MNE with the optimal FSA-A, so as to secure its fullest available potentials. The negative *substitution* effect would then occur if exceptionally effective FSA-R led to a

[14] Emphasis has also been placed on the level (state; province; city and county) at which the governmental affiliation of a possible MNE is activated (Wang et al. 2012a; Child and Rodrigues 2005; Sun et al. 2010). This is likely to affect institutional openness to persuasion through FSA-R. Thus Wang et al. (2012a, p. 660) argue that whereas at the city or county level *local* performance is likely to pre-occupy bureaucratic decision makers, at the state or provincial level they may be 'more concerned with globalisation, openness and integration of the country into the World economy [the Go-Global policy]' and thus more amenable to firms' FSA-R.

project being implemented around far from ideal (or best available) FSA-A, causing suboptimal realization of its possibilities.[15]

Developmental Country-Specific Advantages (CSA-D)

A central aim of our framework is to formalise aspects of the ways that the micro-level internationalization of important elements of Chinese business are embedded within the macro-level dynamics of China's development. Thus we define CSA-D as 'forces that are endogenous to a country's developmental processes that generate resources and/or motivations that can drive and support the international expansion of its firms'. This then encompasses both positive and negative forces or imbalances that emerge within development and which impinge on internationalization through FDI. Here, the CSA-D/+ are manifestations of successful growth in the form of surpluses in capital (savings) and foreign exchange. As will be more systematically discussed in the next section these positive CSA-D can be *allocated* by the policy institutions of Chinese development to help facilitate specific acts of FDI by emergent Chinese MNEs where these are seen to be a potentially significant contribution to the wider needs of sustainability and deepening of China's growth.

This acknowledges the presence of CSA-D/−, in the form of emerging constraints within the successful growth processes that appear to both compromise the persistence of its current bases and limit the immediate emergence of potentials for its medium-term upgrading and refocusing. Comprehension of these negative CSA-D has helped define particular motivations for Chinese business overseas expansion to both secure the prolongation of the current developmental structures (RS) and also to explore the potentials for subsequent movement beyond them into higher-value-added knowledge-based forms (KS).

In our characterisation, we see the core of China's growth as based on the exploitation of level-2 resources in the form of an efficient and cost-competitive supply of productive labour. The sustainability of this has quantitative roots in terms of the supply of workers that has been drawn into the export sector, with an increasingly important qualitative element reflected in the upgrading of its productive potentials (higher skill levels) so as to encompass the still highly competitive supply of higher-value-added goods. But, we have indicated, this may be placing increased pressure on the much-less-elastic domestic supply of level-1 inputs such as energy and minerals. The

[15] The alternative negative substitution effect is, of course, one where the ideal FSA-A are not applied because the firm's weak FSA-R are beaten by those of another enterprise with less appropriate FSA-A.

growing emphasis on the *external* sourcing of such resources (RS) can then be seen as integral to the policies that seek to prolong the competitive viability of the core industrial strategy.[16]

Following on this background in the policies and practicalities of China's development most of the studies of the determinants of its FDI included proxies for RS amongst its variables (Buckley et al. 2007; Duanmu and Guney 2009; Duanmu 2012; Cheung and Qian 2009; Voss 2011; Kolstad and Wiig 2012; Alon 2010; Wang et al. 2012a; Cross et al. 2007). The more wide-ranging studies, in terms of time-period and country coverage, are ambiguous with regard to the pervasiveness of RS in Chinese FDI. But focus on particular subsamples can allow for two, very broad-brush, generalisations. First, RS tends to become more relevant in more recent periods in line with the view (Buckley et al. 2007, p. 511) 'that the securement of natural resources has become an imperative in more recent years, in line with Chinese domestic growth'. Secondly, the most systematic commitments towards RS have become most focused on developing (or non-OECD) countries. Several studies (Asiedu 2006; Biggeri and Sanfilippo 2009; Cheung and Qian 2009) have tended to place Africa in an increasingly significant position as a location of Chinese RS FDI. Overall, this tends to confirm both the increasing relevance of RS as a manifestation of CSA-D/− and its likely positioning as a factor in China's wider relationships with particular host locations.[17]

We have suggested that an important element within the dynamics of China's current competitive development lies in the upgrading of labour-force productiveness through the ability of increased skill levels to perform higher-value-added functions. But this potential of level-2 resources cannot, of itself, provide the higher productivity potentials. This requires the scope-enhancing inputs of creative level-3 resources and the implementation of knowledge-seeking (KS) strategies. It is then, of course, desirable that such innovative opportunities should emerge predominantly in the domestic economy, ultimately within the scopes of local firms. But it is also now widely accepted in IB analysis that the sources of creative knowledge sought by major firms (the

[16] From her wide-ranging review of China's resource policy Moyo (2012, p. 14) indicates that in the context of emerging global resource shortages 'China seems to be the only country that is preparing for this eventuality in a sustainable and deliberately constructive way' through an entry into international resource markets that involves 'a comprehensive three pronged approach: via financial transfers (be it aid or commercial loans), through trade and by means of investment' (Mayo 2012, pp. 75–76).

[17] Biggeri and Sanfilippo (2009) also found a significant positive relationship between African countries' level of production of crude oil and a measure of its bilateral cooperation (the Aid relationship) with China. Thus it is suggested (Biggeri and Sanfilippo 2009, p. 45) that 'Chinese economic cooperation … is driven by the opportunity to establish deeper relations with oil producing countries'.

traditional MNEs here) cannot be constrained to one location, so that decentralised learning processes now define KS strategies in MNEs.[18]

In terms of firm-level analysis, it is FSA-A that then become central to the understanding of the KS strategic positioning. Here again, we can emphasize important differences between traditional MNEs and the role of KS in Chinese and other EM-MNEs. The current mainstream comprehension of KS in traditional MNEs sees this as an essentially evolutionary process, aiming to add new sources of competitiveness in a logical and coherent manner to a mature and fully understood body of successful FSA-A. In this path-dependent progression, the existing FSA-A play two roles. Firstly, they define the basis of the sorts of knowledge that are sought. This would normally be expected to add significant new dimensions to current competitiveness without provoking too much by way of destabilising changes in core perspectives. Secondly, the ability to assess the capacity of potential new knowledge sources to serve this coherently evolutionary role is likely to reside with those scientists and technologists in the firm with the most complete understanding of the strengths and limitations of the present FSA-A.

Against this established perspective, we can discern the enigma of KS as it appears to be emerging in Chinese MNEs. Here, it is usually argued that KS takes place, not to add incrementally to fully formulated and successful FSA-A, but to acquire externally knowledge-based inputs that can feed into those ongoing exploratory processes that are attempting to achieve the sorts of unique and distinctive FSA-A that would ultimately define genuine international competitiveness for the Chinese MNEs. Its current aims are gap-filling rather than logically evolutionary. However, this challenges a key precept of IB theorising. Chinese MNEs' KS investments are being made in reflection of clear acceptance of the need to overcome understood limitations in their knowledge-based FSA-A. But, theory tells us, acts of FDI can only be achieved from a basis in very strong and fully defined FSA-A. Once again, it is necessary to see these incremental micro-level acts of KS FDI as positioned within the wider macro-level needs and strengths of Chinese development.

[18] A number of studies of leading MNEs' operations in China have illustrated extensive knowledge spillovers into the wider economy, through joint ventures, subcontracting relationships, University R&D partnerships and so on. This can also be interpreted as a contribution of IB to the Chinese NSI and its generation of level-3 resource capacities. It can be argued, however, that this is qualitatively different from outward KS by Chinese MNEs. The driving imperative of the foreign MNEs in China is usually to transfer and/or evolve their own knowledge base towards innovation that is driven by and for the local market. Its core is the established capacities of the MNEs as evolved towards the distinctive local needs. It certainly adds to knowledge-driven enhancement of competitiveness in China, including elements that also add dimensions to international competitiveness. But it does not impart the types of uniquely local distinctiveness sought by the NSI. The KS of Chinese MNEs may still be contributing to this in a more individual manner.

KS investments targeted by Chinese firms may be articulated (through FSA-R skills) as beneficial to the wider progress of China's NSI and competitiveness and as, therefore, worthy of Governmental support.

Another facet of this can be discerned from the analysis; the extra uncertainty and riskiness of KS by EM-MNEs. We noted that because traditional MNEs were aiming to build in an informed and logically evolutionary fashion on mature FSA-A, their KS decisions would be strongly guided by those FSA-A that have a high-level of realistic potential. Because the comparable KS decisions of Chinese MNEs are much more fundamentally exploratory, targeting the filling of not fully understood gaps in their knowledge competences, there is a much greater risk of poor decisions that ultimately yield little of relevance. If it is still accepted at the level of developmental policy that KS is a desirable imperative that can most plausibly be best pursued within the strategic motivations of emerging Chinese MNEs, then support from within CSA-I can again be logical. Firm-level KS can therefore be seen as an agent in a certain degree of internationalization of the Chinese NSI in targeting the generation, accessing and assimilation of level-3 resources towards the renewal of the core dimensions of development.

Institutional Country-Specific Advantages (CSA-I)

To complete the framework, we define CSA-I as 'those facets of a country's institutional environment that determine and guide the motivations for an MNE to address particular overseas investment projects and/or provide it with the scope to leverage discriminatory access to resources that help facilitate such acts of internationalization'. As an articulation aimed to mesh with our earlier discussion, this definition incorporates institutions that control access to the CSA-D/+ that can support specific investment opportunities relevant to Chinese MNEs but also include those that address those CSA-D/− that emerge in wider development and thereby favour the pursuit of specific motivations (e.g. RS and KS).[19]

[19] Luo et al. (2010, p. 68) also endorse the need to examine 'the regulatory pillar of the home country's institutional environment [and its attention to] policies enacted by home-country governments' as central to the twin objectives of nurturing the growth of their MNEs alongside promotion of specific motivations for FDI. Thus 'the Chinese government specifically promotes OFDI for the interest of national economic development' (2010, p. 60) through support of individual firms. In our terms the institutional/policy environment (CSA-I) is placed clearly in the context of CSA-D. Later (2010, p. 78) Luo et al. argue that to operate positively in this environment, EM-MNEs 'need to familiarise with government policies, constantly communicate with government agencies, join government-sponsored initiatives, and actively influence new policies and measures'. They need to possess and exercise FSA-R. Empirically, Lu

In terms of wider economic analysis, this potentially amenable institutional context for EM-MNE expansion in the early phases of OFDI differs notably from that we discerned for the early days of the traditional Western MNEs. This has been precisely articulated in terms of the presence of exploitable market imperfections. Thus Buckley et al. (2011, p. 136) suggest that 'close relationships and collusion between the government and domestic businesses can lead to structural and endemic market imperfections which are exploitable by companies that enjoy good relationships with the administration'. Voss (2011, p. 91) observes that the OFDI of China 'has been characterised by market imperfections that arise from the need of firms to be well aligned with government officials and the status and economic rank of the companies'. From this (Voss 2011, p. 96) indicates that 'relational access to governmental bodies that can grant necessary approvals remain an important asset to companies'. Discerning these opportunities and evaluating the relevant imperfections are the essence of our FSA-R.

It is not feasible or necessary here to trace the precise evolution of the relevant components of CSA-I during the various phases of China's increasing involvement with the international implications of its ongoing development. Several studies have reviewed this in admirable and perceptive detail (Luo et al. 2010; Buckley et al. 2007; Cross et al. 2007; Voss 2011).What our framework does require us to do is provide illustrations of how the increasingly detailed policy institutions relevant to Chinese OFDI support micro-level acts of internationalization by these MNEs within a context conditioned by particular macro-level imperatives of home-country development. The analytical conundrum this addresses is that such EM-MNEs are unlikely to expand internationally purely through the exercise of mature OA/FSA-A so that their ability to do so must derive from the ability to access external and conditional sources of home-country support.

The application of this perspective with regard to access to capital encompasses two analytical contentions. Firstly, that an ability to leverage imperfections in domestic capital markets is an exploitable advantage for potential MNEs (Buckley et al. 2007, 2011). Secondly, that this ability to secure capital in such an institutional (as distinct from free-market) context may reflect their willingness and capacity to work within the needs of wider Chinese policies rather than an immediate pursuit of conventional profit-oriented objectives. In broad terms, the EXIM Bank and other state-owned Commercial Banks have been able to provide low lending rates, flexible terms and a fast approval

et al. (2014) showed that 'home-country supportive' policy was a consistently significant determinant of new Chinese investments in samples of both developed and developing host countries for 2002/2009.

process to support Chinese OFDI (Sauvant and Chen 2014, p. 152). This context has included several more precise initiatives. In October 2004, the EXIM Bank and National Development and Reform Commission (NDRC) established a Special Fund of Lending for Investment Overseas aiming to provide credit for OFDI in priority projects. An agreement of February 2006 between the China Development and EXIM Banks extended special financial services (e.g. discounted lending rates) to projects likely to support Chinese development and its emerging MNEs. A fund jointly set up and managed by the Ministry of Commerce (MOFCOM) and the Ministry of Finance also enables the Chinese government to directly subsidise particular OFDI projects, including those in natural resources and 'building foreign R&D centres and machinery and equipment manufacturing facilities, investments in Chinese-built economic and trade zones overseas' (Sauvant and Chen 2014, p. 152).

Naturally foreign exchange plays a major role in the CSA-I narrative since it represents a positive manifestation of one phase in China's development but also becomes a resource available to Chinese MNEs when they are co-opted to play roles in alleviating constraints in the perpetuation of that development or to find ways of re-orientating it. In fact the evolution of institutional policy towards foreign exchange tended to reflect a changing balance between these two forces, with an early emphasis on the accumulation of reserves turning towards an understanding of how they could be activated within developmental priorities. The crucial policy transition here has been characterised (Luo et al. 2010; Voss 2011) as a move from 'earn to use' to 'buy to use' in access to foreign exchange for firms aspiring to FDI, which was embodied in policy reformulations of September 1995.

The principle of 'earn to use' was laid out in the 'first phase' of China's FDI policy (from 1979 to 1985 within the 'Open Door' policies) emphasizing the need for 'retention' and 'accumulation'. Here, firms earning foreign exchange (probably through exporting or trade in this mainly pre-FDI era), had to transfer this to the State Administration for Foreign Exchange (SAFE), with no automatic access to its further use. Nevertheless, 'earn to use' did specify that only firms that had earned and transferred foreign exchange in this way could apply for access in support of intended overseas investment projects. This limiting of scope for FDI to firms with some antecedent international experience constrained this to projects approved by SAFE. The scope for successful, but so far exclusively domestically oriented, firms to develop and secure support for a logical international expansion seemed to be institutionally precluded. However, the later articulation of the 'buy to use' approach loosened this position so that 'foreign exchange entitlements could be bought from SAFE to finance OFDI projects regardless of whether or not the applicant had previously generated foreign exchange through trade' (Voss 2011, p. 75). This opened up foreign exchange as a CSA-D, since any firm that could expand its competitive capacities and potentials towards plausible international operations now had feasible access to the currency needed to do so.

Though firm-level discretion over FDI decisions has only emerged relatively recently, and remains incomplete, the core parameters of the aims to be pursued within the CSA-D/CSA-I approval nexus were clearly defined very early. Thus, 1985 documentation relating to the approval process defined four categories of desirable FDI projects. Firstly, those aimed at securing international access to natural resources. Secondly, those capable of acquiring technology and transferring it back to China. Thirdly, investments related to increasing the export potentials of Chinese enterprises. And lastly, operations that possessed the potential to increase managerial skills through learning processes in overseas activities. These criteria set in place priorities that have remained central to Chinese OFDI policy and underpin our contention that this encourages the micro-level international expansion of Chinese business in ways that feed back into the macro-level progress of home-country development. Very directly, the first objective represents RS and the second KS, as we have discussed them here. The fourth also represents learning processes that have the capacity to enhance FSA-A, but also to feed back into the human capital competence of the home economy. All of these are predominantly home-base enhancing imperatives, with clearly perceived aims in inculcating necessary resources and capacities into the persistence of China's development. The third may be more home-base exploiting, adopting the MS aim of building the overseas market for whatever the current advantages of the home economy can supply.

Though reforms to the arrangements used by institutions such as SAFE, MOFCOM and NDRC have increased the freedom for Chinese enterprises to seek finance and foreign exchange for self-driven projects, the institutionally based consciousness of the need to position China's OFDI and MNEs into the wider perspectives of internationalization and growth remain decisive. A key manifestation of this was the July 2004 issuing of the 'Outbound Catalogue' by the Ministry of Foreign Affairs and MOFCOM. This specified the Government's favoured industrial sectors and host countries and defined the potential treatments, including access to funding, foreign exchange availability, customs and tax incentives, which could become available to firms whose intended investments conformed to the lists (Voss 2011). This has been regularly and systematically updated and seems to be positioned to define CSA-D and CSA-I contexts conditioning the international expansion of core elements of Chinese business.

Our emphasis here is on how home-country institutions influence the emergence of Chinese MNEs. However, this has occurred within the wider context of China's growing involvement with the global economy and its institutions. There has been, to date, no evidence of strong or systematic support for OFDI from particular external institutional arrangements. Thus, studies of the effects of Bilateral Investment Treaties and Double Taxation Treaties on China's OFDI have produced mainly weak, and sometimes counterintuitive, results (Voss 2011; Lu et al. 2014). An exception is the study of Biggeri and Sanfilippo (2009) which found a measure of bilateral cooperation between China and African countries to be a significant determinant of Chinese FDI stocks. Thus, they argue (Biggeri and Sanfilippo 2009, p. 44) that 'economic cooperation projects provide significant opportunities for China to move into foreign countries by creating a synergy between [MNEs] and Central Government'.

Conclusions

The crucial subtext of the analysis offered here is that the early internationalization of Chinese and other EM-MNEs not only represents a significant step in their competitive formulation as *firms* but is also integral to the sustainability and deepening of the development of their home *country*. This, we argued, is very different from the comparable stage for earlier traditional MNEs. There, the theorising suggested, the firms expanded internationally when they considered their competitive abilities had reached levels that would allow them to do so. They did this in ways that were likely to be reflective of the achieved level of development of their home country, but not in any way systemically related to its needs. It is a sense of EM-MNEs' FDI as exploring new competitive potentials, rather than as vehicles for further exploitation of established ones, that has distinguished them as challenges to both the accepted practice and theory of IB. Our theoretical agenda has thus needed to address familiar (micro-level) 'how' and 'why' questions regarding the internationalization processes of the EM-MNEs, but to draw in a much more decisive and strategic commitment of home-country (macro-level) support and motivation in doing so.

Our agenda has focused on an explanation of the *emergence* of EM-MNEs as a contemporary frontier in our understanding of the ever-changing world of IB. To conclude we can suggest that the next analytical frontier involving these firms will be to understand their *evolution* as MNEs. Will they wean themselves off the practical support and strategic positioning mandated by home-country institutions and become increasingly configured around the globalized competitive priorities of conventional 'traditional' MNEs? This would require them to evolve their nascent home-country-derived sources of competitiveness (FSA-A) to the level of stand-alone world-class competences and to build them into the core of globalized multi-country strategic postures. Can they, indeed will they, be permitted to generate the capacities and behavioural motivations to compete in conventional ways with established MNEs in major global industries? The potential to do this would reside in the acceptance of learning processes[20] as central to the initial expectations underpinning the early steps of EM-MNEs, as, indeed, suggested in Chinese policy prescriptions.

Despite the inevitable liabilities of 'foreignness' and 'newness', we can find two potential sources of 'latecomer advantage' that might facilitate these learning processes. Firstly, the new levels of exposure to established competitive norms upon internationalization would provoke an immediate comprehension of the precise limitations of their current FSA-A and point towards the, probably newly available, KS possibilities to alleviate them. Secondly, the practices of managing global competitive strategies are likely to be very different from those that operated in the EM-MNEs' home-country formulation and in the process of internationalization itself. But, again, these can be assimilated by observation of the established norms of global rivals. Indeed, the ability to access and learn these could be facilitated through effective FSA-R expertise. These potential elements of ongoing research agenda suggest that whilst modelling the early emergence of EM-MNEs remains a major part of our analytical frontiers, this needs to now follow those firms' life into the wider contexts of global competition.

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[20] The 'leverage', 'linking' and 'learning' framework (Mathews 2006a, b, 2002) has provided useful insights along these lines.

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6

Business Groups from Emerging Markets: New Actors in International Business

Ayse Coban

Introduction

Although international business (IB) researchers invest a great of effort to understanding the emergence and expansion of multinational enterprises (MNEs) in general (Rugman 2006), not enough is known about Business Groups (BGs) or diversified BGs, which have become dominant actors in most economies, especially emerging ones. Most of these BGs seem to be "*latecomers*" to international markets, emerging over the last decade or so (Luo and Tung 2007). The literature suggests that they offer great potential for IB research since their unique organizational form exploits particular competences from imperfect market conditions (Yiu et al. 2007). Their dominant home bases, emerging economies, also play increasingly important role in producing new MNEs and international players. These new MNEs have expanded MNE theory in different ways and still have the potential to contribute newer theories and probable ones (Ramamurti 2012b).

Due to the rising share of emerging economies and their MNEs in the global economy, it is important to evaluate the different types of organizations that function effectively in these contexts. This chapter, thus, examines the notion of BGs and how they operate in emerging economies and

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international markets. It also aims to contribute to, and extend, IB literature with insights on the specific features and approaches of BGs.

Defining Business Groups

The literature stream on BGs has largely been shaped studies from emerging countries like Brazil, South Korea, India, Thailand, Indonesia and Chile. The roles of institutional environment, law and the state have been influential in the appearance of BGs in emerging economies (Khanna and Yafeh 2007). The international trade and business systems have been more conducive to these economies in the last few decades than the period after World War I. Capitalism manifests itself in different forms in countries where the state and institutional environments significantly determine economic activities; the formation of large-scale organizations and the importance and performance of BGs (Khanna and Yafeh 2010) also differ from country to country (Whitley 1998). This divergence can be seen in the naming of these organizational forms, specifically *keiretsu* in Japan, *chaebol* in South Korea, *qiye jituan* in China, *business houses* in India, *grupos economicos* in Latin America, *guanxi qiye* in Taiwan and *family holdings* in Turkey. Indeed, different stakeholders have tried to define these organizational forms based on their perceived features (Yiu et al. 2007).

Economists view BGs as resulting from market imperfections and the need to reduce transaction costs caused by institutional voids. According to this perspective, the main reason for forming BGs, or groups of firms which operate in diversified industries and are controlled by a common financial mechanism (Leff 1978), is to fulfill the role of "missing" market institutions (Yiu et al. 2007).

The political economy view focuses on the politic-economic factors to understand BGs' strategies, diversified operations and structures, arguing that these cannot be determined only by their top management, but also by the state and policy makers (Ghemawat and Khanna 1998). In cases like China, for example, state ownership, with its highly authoritative structure, and state policy often strongly influence the strategies of BGs (Schneider 2010; Yiu et al. 2007). There is also the relational perspective (social relations view), which highlights the importance of the relationships between institutions involved in economic exchange in understanding BGs (Yiu et al. 2007). This perspective sees BGs as groups of firms which are legally independent but intricately bonded with one another in formal and informal ways. This bonding may take the form of one or more significant persons or family having shares and decision-making position in all of these firms. This type of direct and indirect control, by a family or key people, is exercised by holding or pyramidal structures (Granovetter 2010). Trust and cooperation among these parties are also emphasized in this relational perspective (Granovetter 2010; Yiu et al. 2007).

The resource-based perspective explains BG formation as arising from entrepreneurs' and firms' competences, which help them to enter multiple industries swiftly and cost effectively, using domestic and foreign resources. These competences can be used to great effect when there are asymmetric conditions for international trade and business. This perspective views BGs' diversification strategy as an important approach for acquiring and maintaining domestic and foreign resources (Guillen 2000), particularly as financial and intangible resource sharing within diversified groups permits affiliated firms to benefit from cross-subsidization of internal transactions and perform better (Chang and Hong 2000).

Overall, while the above-mentioned schools of thought emphasize different themes in their conceptualization of BGs, the present study views BGs as legally independent firms which are connected to one another by formal and informal bonds, are operated across several industries and are controlled by a head or central company (Khanna and Yafeh 2007).

The Importance of Business Groups in Emerging Countries

The term "emerging economies" or "emerging markets" is used in this chapter instead of previous terms like "*less developed countries*", "*Third World countries*" and "*newly industrializing countries*", which arguably focused on these countries' cheap resources and labour force more than their markets. In this regard, there are two main criteria to evaluate a country as an "emerging market". These are having a rapid economic growth and regulations that support free market (Arnold and Quelch 1998).

Emerging economies, in general, have a different context than Anglo-Saxon liberal economies (Colpan and Jones 2016). As a result, they have developed unique organization structures (Leff 1978), including BGs. BGs have not been investigated enough in the literature despite their economic effectiveness in many countries and significant positions in the global economy. The previous limited research generally investigated samples from East Asian countries, known as "Asian Tigers", to understand the structure, strategy, performance and governance mechanisms of BGs—these have not changed despite market liberalization and neo-liberal policies in these countries (Colpan et al. 2010).

In today's economic environment, BGs are prevalent across different geographic areas like Asia, Latin America and Middle East (Colpan and Jones 2016). The prevalence of institutional voids, including underdeveloped laws and legal system, and high transaction costs are among the basic reasons why BGs develop and function well in emerging markets. When minority shareholders are not protected well enough, pyramidal BGs with family-controlled shares commonly emerge, and in times of rigid state control over economy, they ensure their growth and continuity by establishing intimacies with state and political figures. Although emerging economies typically differ regarding specific features of their institutional environment, their generic privatization policies and banking regulations have enabled BGs to get a bigger share in the economic growth of their respective countries. Also, their country's determination to establish a national capital structure has helped BGs, by the facilitating relationships with state actors (Yiu et al. 2007) and availing them of advantages over foreign multinational companies (Khanna and Yafeh 2010; Schneider 2010). Given this absence of effective free market conditions, BGs have generally preferred horizontal mergers, vertical foreclosure, entry deterrence and such mechanisms to increase market power in their home countries since (Khanna and Yafeh 2010).

BGs also tend to achieve considerably high profits in their own economies. Relevant literature suggests that BG-affiliated firms generate higher profits than independent firms in India, Indonesia and Taiwan, though evidence for firms in Israel, South Africa and Peru is insufficient (Khanna and Rivkin 2001). Trade barriers and weak antitrust enforcement in emerging economies are thought to help BGs in strengthening their monopoly power (Khanna and Yafeh 2010).

The relationship between BG affiliation and firm performance has been investigated in various studies, which reported diverse results (Chang and Hong 2000; He et al. 2013; Keister 1998; Khanna and Rivkin 2001; Ma et al. 2006; Singh and Gaur 2009). It seems that BG-affiliated firms show high performance scores when they benefit from resource sharing and decreased transaction costs in intragroup activities (Chang and Hong 2000; Khanna and Palepu 2000). As Chang and Hong (2000) noted, by becoming an affiliate of a BG, firms can benefit from both tangible and intangible resources. Also, the structure of BGs, which permits interlocking directorates and involvement of powerful financial institutions, may promote affiliate firm performance (Keister 1998), so are financial and labour market failures and voids (Carney et al. 2011; Xavier et al. 2014) and BGs' participation in capital markets of reforming emerging markets (Chittoor et al. 2015). On the other hand, in some cases, BGs' affiliation can cause a negative or no effect on firm performance (He et al. 2013; Ma et al. 2006; Singh and Gaur 2009). In a detailed study, Yiu et al. (2005) found that BGs' age, state ownership and governmental experience of top management have a negative effect on firm performance.

Although BGs serve as intermediate structures to mitigate for institutional voids in emerging markets, evolution toward more free market arrangements seems to be affecting them in certain ways (Carney et al. 2011; Khanna and Palepu 2000). Notably, rapid pro-market reforms in emerging markets seem to be lessening the performance of BGs, especially family-controlled ones (Banalieva et al. 2015).

While BGs are so effective and dominant in their domestic markets, they have, in some cases, appeared reluctant to be part of the global economy and international trade. Gubbi et al. (2015), for example, found the international search efforts of BG-affiliated firms to be of a lower level than those of independent firms in Indian pharmaceutical industry despite the advantages associated with the former's intragroup position and market power. This may explain the reported decline in BG-affiliated firms' performance when they undertake international diversification (Gaur and Delios 2015; Kim et al. 2010), even more so in rapidly changing institutional environments. However, as the institutional environment settles down and free market conditions prevail, BG-affiliated firms' performance tends to be stronger than that of independent firms during international diversification (Kim et al. 2010). This reinforces Yiu et al.'s (2005) finding that international diversification promotes BG performance.

Market developments in emerging economies also exert considerable influence on the entrepreneurial actions of BGs and their affiliated firms. While the number of BGs' formal startups tends to decrease as markets develop, the growth potential of these formal startups and higher presence of foreign firms in privatized industries can be interpreted as suggesting greater entrepreneurial capacity and more effective usage of competitive advantages and valuable resources (Barney 1991; Chari and Dixit 2015). Such perceived competitive advantage is also a key factor for BGs and their affiliates in undertaking foreign direct investment (FDI) activity (Chari 2013).

Business Groups in Turkey

As of 2010, there were 80 BGs and 156 BG-affiliated firms in the İstanbul Chamber of Industry's list of largest 500 companies, and 119 BGs and 240 BG-affiliated firms in the Chamber's list of largest 1000 companies (Dirlik 2014).

Large-scale corporations in Turkey can be categorized into two major groups. The first are family businesses which have grown steadily and expanded their capital base since the founding of the Turkish Republic. The second group includes enterprises that are controlled by the government and founded after the 1930s' statist economy politics. The most well-known BGs are family-owned enterprises referred to as "*holding*", which go back to the beginnings of the twentieth century and operate many diversified businesses in the Turkish economy.

The neo-liberal politics that prevailed after the 1980s additionally led to the emergence of a new bunch of BGs, which also operate in many diversified industries (Colpan 2010; Colpan and Hikino 2008). This policy of establishing an indigenous business class for the new Turkish Republic facilitated the adoption of BG organizational form by entrepreneurs and Turkish businessmen (Buğra 1995; Colpan and Hikino 2008). Also crucial in influencing the industrial diversification strategy of Turkish BGs were International Monetary Fund's support for developing free market economy after the country's 1980 military coup and the large state-funded infrastructure investments and international trade incentives (Buğra 1995).

Additionally, the outward-oriented economic policies introduced after the 1980s, including the 1995 customs union pact, substantially encouraged all BGs in Turkey to develop their international operations (Colpan 2010; Colpan and Hikino 2008) and diversify their activities in many regions, especially in Europe. This new business class seemingly chose the diversification approach to reduce risks associated with the state's perpetual interventions to economy and in so doing increase their size and economic involvement in Turkey (Colpan and Hikino 2008; Gökşen and Üsdiken 2001).

Reflecting the above-noted changes in the Turkish institutional environment, economy and politics, BGs have been labeled as "*old*" (those established between 1920 and 1950) and "*new*" (established after 1980) by scholars in this literature stream (Colpan and Hikino 2008; Gökşen and Üsdiken 2001; Özkara et al. 2008). Gökşen and Üsdiken (2001) and Özkara et al. (2008) similarly referred to BGs established before 1980 (state-controlled economy era) as "*old*" and those founded after 1980 (liberalization period) as "*new*". In yet another classification of Turkish BGs, Yaprak et al. (2006) suggested four types of BGs, namely, holding company BGs, emergent BGs, encouraged networks and regional networks. Holding company BGs are highly diversified ones that comprise 60–100 companies, diversified rapidly during Turkey's import substitution period, and are owned by highly reputable families (e.g. Koc Holding, Sabancı Holding, Alarko Holding and Zorlu Holding) (Buğra 1995; Yaprak et al. 2006). Emergent BGs, like their holding company counterparts, are also highly diversified in industries like foods and cereals, automotive products, tourism and machinery and have taken advantage of the state's market liberalization incentives to grow subsidiary networks of small- and medium-sized companies. Encouraged networks, emerged after Turkey's Customs Union agreement and consisted of companies which produce similar products, are free of antitrust legislation and are established as confederations via social, economic and kinship ties. The last type of BGs, regional networks, involves small- and medium-sized enterprises that focus on significant industries and collaborate through supplier arrangements, co-production and technological tie-ups (Yaprak et al. 2006). Besides historical changes in Turkey's economic policy, sociopolitical changes in government mechanisms have also produced new BGs that are motivated by Islamic background and class mobility. These new groups have benefited from close relations with the post-2002 governing party of Turkey and have shown incredible performance in international trade (Özcan and Turunç 2011).

The literature has tried to analyze whether any differences can be found among Turkish BGs based on their time of founding. While Colpan and Hikino (2008) found no significant difference between the degree of diversification of "*old*" and "*new*" BGs, Özkara et al. (2008) stated that "*old*" BGs have diversified much more than "*new*" ones. The level of internationalization of Turkish BGs has also been investigated, and it has been found that older BGs are more export oriented (Gökşen and Üsdiken 2001). Turkish BGs start their internationalization process not only via exporting but also by establishing joint ventures (JVs) in their home country. Older BGs seem to be more successful in establishing these investments (Özkara et al. 2008). Gökşen and Üsdiken (2001), however, reported contrasting findings.

These internationalization strategies pursued by both older and newer Turkish BGs have enabled them to accelerate their outward internationalization and direct investment activities (Ataay 2012), and they have been assisted in this process by the unrelated diversification activities, size and previous alliances with foreign MNEs operating in Turkey. Board characteristics are also another potential influence on Turkish BGs' internationalization performance (Selekler-Göksen and Yildirim-Öktem 2008). Furthermore, these BGs have effectively deployed valuable resources and competitive advantages associated with their emerging country context in their inward and outward internationalization processes (Ataay 2012; Dirlik and Asunakutlu 2014).

Despite the foregoing wealth of evidence, the earlier noted inconsistent results about Turkish BGs suggest the continuing need to investigate the importance of BGs in Turkey's economy. More comprehensive theoretical frameworks may help researchers to clarify the differences among BGs.

Business Groups and Internationalization

BGs are generally known for their use of unrelated diversification strategies to reduce risks and take advantage of their underdeveloped domestic markets, and this strategy has helped to promote their overall performance (Chang and Hong 2000; Khanna and Palepu 2000). In dominating their domestic markets, they have also utilized early mover advantages, government protection, foreign alliances, unrelated diversification, low home market competitive intensity and easy access to source of capital (Kim et al. 2004). BGs like LG (South Korea), Haier (China), Huawei (China), Tata Group (India), Koç Group (Turkey), Formosa Plastics Group (Taiwan) and Siam Cement Group (Thailand) have been the major players in their domestic markets and have shown high potential to expand globally. This dominant market position of emerging market BGs, and their apparent market knowledge, supplementary capabilities and significant domestic market competences, meant that they were the main partners for developed country MNEs during the market liberalization process in their home countries, partnership which further facilitated their access to financial and intangible assets, and technological and managerial capabilities (Hitt et al. 2000). The experience of collaborating and competing with developed country MNEs in their domestic markets has also contributed to the outward internationalization of these emerging market firms, and their ability to survive the liberalization of their domestic markets has made them interesting cases for IB scholars (Ramamurti 2012a).

Although BGs have contributed significantly to their countries' FDI activity (e.g. 28 percent of China's outward foreign direct investment in 2006 [Sutherland 2009]), there has been limited research about their internationalization (Yiu et al. 2013). Most previous studies about Turkish BGs' internationalization have overlapped with the emerging multinationals' literature, like in other emerging country contexts, and taken a resource-based or institution-based view (Dirlik and Asunakutlu 2014; Selekler-Göksen and Yildirim-Öktem 2008; Yaprak and Karademir 2010), both of which arguably complement each other in providing broad understanding of BGs' internationalization, for example, how this process is affected by pervasive institutional voids in their home markets (Aharoni 2014; Chari and Acikgoz 2016; Demirbag et al. 2007; Dunning 1998; Dunning and Lundan 2008; Erdilek 2008; Holtbrügge and Kreppel 2012; Peng 2012; Ramamurti 2012b; Stal and Cuervo-Cazurra 2011).

To better understand the motivations and behaviours of newly emerging market multinationals, including BGs, and their rather surprising path of FDI activity, which reverses the traditional direction of global capital, technology and knowledge flows (Ramamurti 2009), IB scholars have headed toward a new direction in search of more efficacious theories seem (Aharoni 2014). As a consequence, new approaches like Mathews's (2006) Linkage-Leverage-Learning (L-L-L) framework and Luo and Tung's (2007) springboard perspective, among others, have emerged to fill holes in MNE theory for emerging multinationals.

Viewed from Mathew's L-L-L perspective, for example, BGs can be seen as offering micro-institutional channels in emerging countries for producing ownership, location and internalization advantages that can be utilized for linkage, leverage and learning purposes in international markets (Yiu 2011). BG affiliates can deploy their internalization advantages, for example, cost-reducing horizontal and vertical linkages in domestic markets, to pursue market-seeking strategies abroad (Yiu et al. 2013). Also, the challenge of "*liability of foreignness*" for emerging country firms can be ameliorated through membership of a BG network, given the significant resource base, capabilities and rising reputation of such organizations in global markets (Singla and George 2013; Zaheer 1995). Furthermore, such attributes, coupled with the support of government and ethnic networks, can reduce whatever unfavorable effects internationalization might have on the performance of BG-affiliated firms (Luo et al. 2010; Peng 2012; Sim and Pandian 2003; Singla and George 2013).

Turkish BGs, like their earlier-mentioned emerging market counterparts, have shown high potential to expand globally. Due to their valuable resources and competitive advantages, Turkish BGs were generally the preferred options for foreign MNEs seeking alliances in Turkish domestic market. It is, therefore, not surprising that the largest Turkish BG (Koç Group) is the first one to internationalize substantially among its domestic rivals (Ataay 2012). The knowledge and technological skills acquired from these initial inward internationalization activities enabled Turkish BGs to undertake outward internationalization activities in neighboring regions and subsequently more developed economies (Ataay 2012; Dirlik and Asunakutlu 2014; Yaprak and

Karademir 2011). Koç Group's Arçelik is a well-known example of how a reputable domestic brand has become an emerging MNE. Arçelik has been the most successful brand in Turkey's white goods sector and has developed its international operations, brand image and technological capability through smart investments or acquisitions of foreign well-known brands (Bonaglia et al. 2007). Presumably, this accelerated internationalization of Arçelik has been fed by competences of Koç Group and easy access to financial resources. The ability of Turkish BGs to combat and successfully manage uncertain institutional environment in other underdeveloped markets appears to be another important factor (Erdilek 2008; Yaprak and Karademir 2010). In some cases, Turkish BGs have served as suitable partners for developed country MNEs aiming to enter other emerging and transition countries within Turkey's geographical cluster. For example, Coca Cola entered Iraqi market via a JV with Anadolu Efes (Anadolu Group) and an Iraqi local company (Yaprak and Karademir 2011). The high potential of Turkish BGs in outward internationalization can be seen from the reports of Foreign Economic Relations Board of Turkey (DEIK), prepared by Vale Columbia Center (VCC) on Sustainable International Investment, Columbia University, New York, USA, and Kadir Has University (KHU), Istanbul, Turkey (DEIK 2009, 2011, 2014). The list in Table 6.1 does not cover the biggest companies in Turkey, but the ones that have participated in the surveys of DEIK. As can be seen from Table 6.1, most of the attendees of the survey are BGs, and their number has increased as time passed. Except Turkish Petroleum Corporation, BGs or their affiliates seem to have the highest rankings in foreign assets among the listed companies (DEIK 2009, 2011, 2014).

Conclusion

The IB literature and global economy have both been enriched by the increased numbers and operations of MNEs since the 1970s (Dunning 1998). However, most of the dominant theories for understanding MNE behaviour and strategy have struggled to fully explain new MNEs from emerging markets as they were conceptualized from the perspective of developed country MNEs, which experience markedly different institutional and global contexts than their newer counterparts (Ramamurti 2009; Yaprak and Karademir 2010). Although this MNE research stream overlaps with the BGs' literature, a dedicated focus on BGs, separate from emerging multinationals, emerging country firms or other variants, may open up new avenues for IB research. For example, given the suggestion in the literature that most BGs, especially

Table 6.1 List of Turkish multinational companies (USD million)

	2007		2009		2012		
Name	Foreign assets	Rank	Foreign assets	Rank	Foreign assets	Rank	Type
Enka Construction	3877	1	3195	3	3779	3	BG Affiliate
Turkcell	2331	2	2996	4	1057	12	BG
Çalık Holding	2002	3	2633	5	816	15	BG
Koç Holding	1742	4	1160	7	3333	4	BG
Anadolu Group	1629	5	–	–	4443	2	BG
Turkish Petroleum Corporation	1121	6	1254	6	4872	1	SOE*
Şişecam A.Ş.	977	7	1129	8	1368	7	BG
Tekfen Holding	751	8	1003	9	1250	9	BG
Sabancı Holding	640	9	8051	1	828	14	BG
Eczacıbaşı Holding	266	10	262	15	371	24	BG
Borusan Holding	223	11	235	16	973	13	BG
Zorlu Energy Group	152	12	459	13	1120	10	BG Affiliate
Doğuş Group	–	–	6357	2	3104	5	BG
Doğan Holding	–	–	801	10	486	20	BG
Alarko Group	–	–	636	11	651	18	BG
TAV Holding	–	–	571	12	1081	11	BG
Orhan Holding	–	–	293	14	534	19	BG
Yıldız Holding (Ulker)	–	–	165	17	1277	8	BG
Eroglu Holding	–	–	106	18	148	28	BG
Çelebi Holding	–	–	95	19	167	27	BG
Yıldırım Holding	–	–	–	–	1867	6	BG
Hayat Holding	–	–	–	–	780	16	BG
Gübretaş	–	–	–	–	686	17	Co-operative Affiliate
Türk Telekom	–	–	–	–	444	21	Foreign Company
Turkish Airlines	–	–	–	–	400	22	State-Owned-Enterprise
Ekol Logistics	–	–	–	–	375	23	Logistics Company
Kürüm Holding	–	–	–	–	281	25	BG
Teklas	–	–	–	–	175	26	Automotive Company
Evyap	–	–	–	–	98	29	Consumer Products Company

Source: Adopted from Survey Lists of DEIK-KHU-VCC in 2009, 2011, 2014 Reports
Note: This table is adapted from three different survey results, and the information is lacking about some companies because they did not participate in some of the years. The relevant reports can also be found on the websites of DEIK and VCC, English and Turkish versions. The necessary permits about using surveys in academic studies were obtained from the appropriate authorities.
*State Owned Enterprise

Turkish BGs, have exploited valuable resources and capabilities generally resulting from market imperfections and domestic market institutional voids for both inward and outward internationalization, investigating BGs from a resource-based perspective might offer important insights for understanding the ownership-specific advantages utilized by such companies in their international expansion (Gammeltoft et al. 2010; Johanson and Martín 2015; Ramamurti 2009).

Also, although extant theories, notably Dunning's eclectic paradigm and Mathew's L-L-L framework (Dunning 1988; Mathews 2006), acknowledge the importance of BGs' vast potential to internalize transaction costs in their home markets in their international expansion, more work appears to be needed to fully understand the impact of their governance structure, including institutional support, on their internationalization motives and strategies. This channel of research can further expand the use of institution-based approach in the BG literature (Yiu 2011).

The IB field can also draw on the internationalization paths taken by some Turkish BG affiliates as significant cases for illustrating incremental internationalization strategies (Johanson and Wiedersheim-Paul 1975), the emergence of emerging market multinationals (e.g. Arçelik) or the diverse international formations of BGs motivated by resource-seeking, market-seeking, efficiency-seeking and strategic asset-seeking factors.

Finally, it is important to evaluate emerging market firms differently than developed economy firms and to distinguish specific forms of emerging market organizations for a richer understanding of the internationalization phenomenon.

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7

The Internationalization of New Russian Ventures: The Institutional Frontier

Igor Laine and Olli Kuivalainen

Introduction

Although institutional transition evolves differently in previously command economies, the liberalization of markets and economic globalization have generally led to the increasing role of entrepreneurship and opening up of opportunities for entrepreneurial internationalization in these countries. Entrepreneurship and internationalization only recently became a legitimate form of activity in these countries, and the realization of their currently under-tapped potential for economic growth is largely dependent on adequate institutional development in these countries. Russia is a critical example of a country where levels of entrepreneurial activity and internationalization are far below comparative countries (Singer et al. 2015; Verkhovskaia and Dorokhina 2014), and the levels the country could and should achieve in order to be competitive in the global economy. This study argues that the institutional environment was and still is a major reason for this problem, and thus concerted institutional re-engineering is an important new frontier for boosting new venture creation and entrepreneurial internationalization. In order to understand how the institutional environment hinders the internationalization of new Russian ventures, one should consider how decision-makers perceive it. Accordingly, this study explores institutional constraints

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to the internationalization of new ventures in Russia based on the experience of entrepreneurs.

Economic Growth, Institutions and Entrepreneurship in Russia

Initially, the transition of the Russian economy toward freer markets was fast, radical and aggressive, but in recent years, the country partially retreated from the course and appears to be increasing the role of the government in the economy. After the August 1998 financial crisis, economic liberalization measures, including currency devaluation, rising commodity prices, consumer boom and ongoing liberal reforms, gave a growth boost to the Russian economy and turned it into an emerging market developing at a remarkable rate. The subsequent global financial crisis of 2008 was sharp for the country, but brief due to proactive and timely measures by the Russian government and Central Bank. Starting from 2009, the country showed an impressive recovery and was in 2012, according to *Financial Times*' economic performance estimate based on seven indicators, ranked number two among G20 economies (Atkins 2012). The growth of the economy, however, slowed from 2013, reaching zero level in 2014 and 3.7 percent in 2015.

In relation to international trade, membership of the World Trade Organization since August 2012 implies a gradual reduction in trade barriers for cross-border trade, which provides certain stimuli for entrepreneurial internationalization. Additionally, the establishment of the Eurasia Economic Union with four neighbouring countries is another facilitating factor. Also, the devaluation of national currency presents an attractive opportunity for international entrepreneurship, notably exporting and sourcing, from Russia. On the other hand, sanctions imposed by a multitude of Western economies since spring 2014 hinder international trade possibilities for certain categories of goods as well as access to global financial markets. While Western sanctions were supposedly targeted at a limited group of political figures and large state-affiliated business entities, their impact has a major bandwagon effect and intensified challenges that the Russian economy was already facing.

According to a recent Organization for Economic Cooperation and Development (OECD) report, the role of entrepreneurship in Russia on the country's economy is relatively small compared to other OECD countries in terms of the number of enterprises, employment figures, and generated output and investments (OECD 2015). Likewise, the Global Entrepreneurship Monitor indicates that in 2014, just 2.4 percent of adults were involved in venture creation activities, which is far below other efficiency-driven economies. Also, only 27 percent of adult population perceived good opportunities for starting a business in Russia (Singer et al. 2015). It has been found that the development of entrepreneurship in Russia is largely hindered by the weakness of its formal institutions, such as property rights and contract enforcement (Aidis et al. 2008; Alon and Rottig 2013). However, the World Bank's Doing Business data, 2009–2015, on the ease or difficulty of starting and operating a business and related business regulations (see Table 7.1), suggest a dramatic improvement in Russia's overall ranking (though not regarding trading across borders) (World Bank 2016).

Statistics provided by the Index of Economic Freedom on Russia show that business, trade and fiscal freedom are all above the world average, while financial, investment, property and freedom from corruption are far below (Miller and Kim 2015). In fact, while the indicator of fiscal freedom in Russia suggests a relatively low tax burden, the perceived effect of tax burden is reported to be, by far, the most important obstacle to local entrepreneurs (World Bank 2012). The objective indicator measured by the total amount of collected taxes does not reflect the subjective perceptions of entrepreneurs, which tend to be much worse. Another interesting fact is that, although the Index of Economic Freedom shows that trading freedom (a composite measure of the absence of tariff and non-tariff barriers that affect imports and exports of goods and services) has been gradually improving and, by 2014, has reached levels of the most developed economies (Miller et al. 2013), this has not led to any increase in rates of entrepreneurial internationalization in Russia. It can be suggested that the reason for this may lie in informal institutions; while there are many rankings and reports focusing on formal institutional frameworks, informal institutions are not easily measurable. At the same time, according to another study, as much as 60 percent of economic activities in emerging economies are driven by informal institutions, including values, norms and beliefs spread in a society (Webb et al. 2009). Given also the many other observed inconsistencies between statistical indicators and real-life experiences, we see our study as particularly relevant in providing evidence-based explanations. The next section describes our methodological approach in filling the gaps on the crossroads of international entrepreneurship and institutions as experienced by entrepreneurs.

Table 7.1 Russia's World Bank Doing Business rankings (out of 189 economies)

Year ranking	2009	2010	2011	2012	2013	2014	2015	2016
Ease of doing business	120	116	123	120	112	92	62	51
Trading across borders	161	162	162	160	162	157	155	170

Source: World Bank (2016)

Methodology

To gain greater insights and investigate in more detail the impact of the institutional environment on entrepreneurial growth and internationalization as it is experienced by practicing entrepreneurs in Russia, we rely on *hermeneutic (interpretive) phenomenology* (Heidegger 1962) as a philosophical and methodological standpoint guiding this study. While there are many definitions and conceptualizations of phenomenology offered by different scholars, they all agree that phenomenology has the "potential to penetrate deep to the human experience and trace the essence of a phenomenon and explicate it in its original form as experienced by the individuals" (Kafle 2011, p. 183). Generally, "a phenomenological study is one that focuses on descriptions of what people experience and how it is that they experience what they experience" (Patton 2015, p. 117). The hermeneutic (interpretive) version of phenomenology differentiates itself from the pure phenomenology in a way that it allows for interpretation of the lived experiences rather than providing mere descriptive accounts. In so doing, it focuses on people's meaning of a lived experience of a focal phenomenon in order to describe the essence of experiencing the phenomena (Seymour 2007). Thus, this particular philosophical and methodological stance has clear correspondence with the purpose of this study and provides guidelines for the subsequent data collection and analysis (Berglund 2007; Cope 2005). Additionally, phenomenology allows to integrate within one study intra-individual cognitions with extra-individual discourses (Berglund 2015), thus illuminating both individual cognitions and institutionally transmitted discourses. The current study employs a qualitative methodology seeking for "better stories, not better constructs" (Dyer and Wilkins 1991, p. 613), although operating with extensive quantity of interview data. The chosen analytical approach entails step-by-step synthesizing of the interview data selected for the study. The phenomenological focus of this qualitative inquiry implies getting at the essence of the experience of how institutional environment affects growth and internationalization of Russian ventures through analyzing interviews with entrepreneurs.

Description of Data

The phenomenological research approach implies *bracketing* all the preconceived knowledge on the phenomenon at the stage of data collection. In our study, the interviews were conducted by other practicing entrepreneurs before the study was initiated, thus naturally preventing the bias of pushing theoretical perspectives toward interviewees. The data came from two publicly available series of videotaped interviews with entrepreneurs conducted by two other practicing entrepreneurs.[1] The interviews were not organized for the purpose of the current research; hence, the data are a secondary source with a disadvantage of being less specific to our research needs. That said, the fact that it is hardly possible for Russian entrepreneurs to avoid topics related to institutions no matter how general the interview itself is arguably mitigates the above-noted disadvantage. The data analysis confirmed our presumption on this matter. Another advantage of the data is that interviews were conducted by entrepreneurs themselves in a friendly and open manner, and the interviewees appeared ready to share their lived experience honestly and deliver rather sensitive information. Some of the interviewees are friends, while others belong either to "big names" of Russian business or to young generation of entrepreneurs. The first set of records contains 146 interviews (BS1 to BS146) held from October 2009 to September 2013, while the second set, consisting of 67 interviews (MD1 to MD67), was recorded between May 2014 and September 2015. Thus, the core data for this study contain 213 transcribed interviews, 116 hours of records and 1290 pages of transcripts. Importantly, these series were shot in two temporally sequential, but rather distinct intervals when considering the institutional environment in Russia. The former timeframe, when the first series were shot, started right after the revival from the global economic crisis of 2008 and belongs to the generally untroubled presidency of Dmitry Medvedev, who was relatively liberal toward entrepreneurship. The latter period, under the presidency of Vladimir Putin, refers to sharply decreased oil prices, armed conflict in Ukraine and related two-way trade sanctions between Russia and the Western world, which all have had negative influence on the Russian economy. Among the interviewees, we not only have Russian entrepreneurs of different age, gender and scale, but also investors, government representatives and foreign entrepreneurs doing business in Russia, thus providing opinions from different perspectives (Table 7.2).

The majority of interviewees were born in Russia, while 19 of others are from former Soviet Union countries and 10 are of a foreign origin. The average age at the date of interview is 39.5 years, which matches the latest figures

[1] The interviews can be accessed by the following links: www.tinkov.com/bizsekrety and www.probusinesstv.ru/programs/75/

Table 7.2 Classification statistics (N = 213)

Scale	%	Experience	%	Age group	%	Gender	%
Local	68	Business	75	Younger (born after 1973)[a]	40	Male	90
National	9	International	30	Older (born before 1973)	60	Female	10
International	9						
Global	14						

[a]The arbitrary year 1973 is chosen as year of birth for people who turned 18 at 1991 (collapse of the USSR)

from the Global Entrepreneurship Monitor report on Russia (Verkhovskaia and Dorokhina 2014). Gender distribution reflects the dominance of males in entrepreneurship, corresponding with secondary data (Verkhovskaia and Dorokhina 2014).

Data Analysis

In our analysis, we investigate the influence of institutional environment on venture creation, growth and internationalization as it is reflected in the experience, attitudes and perceptions of the interviewed entrepreneurs. In order to organize and analyze the large amount of information, we utilized a computer-assisted qualitative data analysis software package, in our case NVIVO 11. In our analysis, we followed guidelines for the phenomenological research approach (Giorgi 1985; van Manen 1990; Smith et al. 1999), which were also applied in other studies on entrepreneurship (Berglund 2007; Cope 2005, 2011).

Overall, our analysis included five basic steps. The first step involved watching the full set of videos in order to obtain a sense of the whole of the phenomenon as described. The second step, generally referred to as *horizonalization*, implied more thorough analysis of individual interviews and corresponding transcripts with the aim of extracting and labeling all the significant statements (meaning units) related to the experience of the focal phenomenon. The third step was the grouping and categorization of isolated meaning units into thematic categories (clusters of meanings), where categories with similar meanings were merged and others split up in the process. This step was finished when all the significant statements were assigned to some category. On the fourth step, the identified categories were grouped into factors, while factors were further reduced to dimensions where possible. The final step was the interpretation and synthesis of the combined evidence leading to what we have reported in the results section. To be able to meaningfully interpret the data and integrate the results with the existing body of knowledge, available academic studies and external research reports about entrepreneurship in Russia and institutional factors involved in entrepreneurship, such as the Global Entrepreneurship Monitor (GEM) and World Bank Doing Business report, were taken into consideration; hence, the findings of our study were discussed in order to address particular problematic issues raised by aggregate figures from the secondary reports as well as explain surprising research results obtained elsewhere (Volchek et al. 2013).

Results and Discussion

Toward an Integrative Framework of Entrepreneurial Cognition

The results and discussion section is largely based on obtained direct quotes, which helpfully deliver a thick description and contribute to the trustworthiness of the study (Lincoln and Guba 1985). Using multiple sources of evidence, our analysis shows that there is a discrepancy between attitudes and behaviour based on personal experience versus those framed by external institutional factors (see Table 7.3). A similar pattern or relationship is also observed between cognition framed on the basis of personal experience and that mostly based on institutionally shared knowledge. Particularly, in most cases, when entrepreneurial cognitions are based on personal experiences, they reflect more positive attitudes toward venture creation, domestic growth and internationalization, while institutionally transmitted knowledge and social pressures suggest abandoning these intentions.

In other words, in a situation when nascent entrepreneurs do not have any or have only limited experience to frame their cognition, they have to overcome these effectively strong institutional pressures. Notably, very low perception of capabilities[2] (27.8 percent) corresponds to a cultural-cognitive pillar and amplifies the negative effect from the above-mentioned social pressures (Singer et al. 2015). In general, every entrepreneurial intention before implementation first goes through the process of cognitive feasibility analysis that is shaped by the combination of personal experience and institutional forces.

[2] Measured by GEM as the percentage of individuals who believe they have the required skills, knowledge and experience to start a new venture.

Table 7.3 Entrepreneurial cognition in entrepreneurship and internationalization

Experience-based cognition	Institutionally-driven cognition
MD5: *I think that all these fairytales about how difficult it is to do business in China are very much subjective* (entrepreneur actively developing his business in China) MD3: *Frankly speaking, I often do not understand when someone speaks of a monstrous corruption in Russia. I have been in the business for the last 25 years and I do not remember that someone extorted money from me, rather I had experience of offering money myself to solve a problem more optimally. I have been faced with the bureaucracy in many countries, and I must say that ours is not the worst one. Here, in most cases, you can always reach an agreement, in contrast to e.g. France. For example, if you would like to start your own business you can easily establish sole proprietorship and get benefits such as reduced tax rates.* BS46: *I think there is nothing so frightening to be afraid of doing business here. We are always frightened: there is a huge administrative burden, monstrous tax authority and other state agencies, but knock wood, we have not had any problems with the state for all these ten years. I mean yeah, a lot of nonsense, but in general, it is not so difficult to do business in Russia as people think.*	MD2: *When we decided to start up, everyone told us that we are going to fail, that we don't have enough money to start up, that we live in our dreams. Even our parents told us that our idea is silly. Thereat, I decided to take a strong step and stop talking to people who demotivate me.* BS32: *It is pretty clear that what's yours here is not always yours, somebody can come and take it away … I think there are rules, I think they are clear and I think if you do not work within those rules and boundaries, the state can come and take anything away.* BS53: *When you try to discuss and share your business ideas with anyone else, first what you get in feedback are dozens of reasons of why you will fail. These negative attitudes are in the air and it's somehow connected to education. If a person tries to do something the environment somehow subconsciously prevents him from doing it.*

The following vivid story describes how experience helps entrepreneurs to go through seemingly deterrent burdens of regulative environment:

MD37: *When I have just started this venture, every quarter I had discussions with tax inspectors. I was blamed in violations, and on my question what I was violating they stated that my venture is unprofitable and asked to explain why. I explained: "We have an investment project and our shareholders invested their money in the company. This money is consumed to create the product".—"No, you cannot do this; we have to call on the commission to analyze your behaviour". Does it help? It seems to me not conducive at all. Of course, having had enough experience behind and, in particular, the experience in dealing with regulatory bodies, I did perceive the situation with humor:—"OK, let's have a commission and*

> *discuss it together. I'll listen to your suggestions how to lead out the company from such a terrible state when it does not bring profit from day one". I suppose someone without experience would be threatened to death by being called for commission and think he would better find a job.*

Being threatened by such regulative pressures, a large number of people abandoned starting a entrepreneurial career in favour of having a more stable job elsewhere, whereas institutionally encouraged careers are found in large state-affiliated enterprises, military or federal security services (BS10; MD37). Given the Global Entrepreneurship Monitor's observation that negative perceptions of venture creation opportunities and of the external environment, so extensively shared among non-entrepreneurs, could be halting the influx of new entrepreneurs, tackling this perception is critically important (Singer et al. 2015). For potential entrepreneurs with a legitimate business opportunity in mind and without previous experience, the difficulty of overcoming these pressures from informal institutions may prevent them from becoming entrepreneurs and leave them with good ideas that go unfulfilled. Interestingly for entrepreneurs, opportunities for venture creation and perceptions of favourability of the external environment in Russia are more than twice higher than for non-entrepreneurs (Verkhovskaia and Dorokhina 2014), thus indirectly supporting our general idea that experience-based cognition is largely distinct from cognition that is solely based on institutionally driven knowledge. The remaining part of the section is devoted to describing the impact of the institutional environment on entrepreneurial intentions.

Regulative Institutions and Collision with Informal Institutions

While public policy plays a major role in building favorable regulative conditions for entrepreneurship, constant changes in legislation and inconsistent and ambiguous laws hinder entrepreneurial activity (OECD 2005). Our study reveals that the general attitude of entrepreneurs toward current laws and policies in Russia is that, when developing particular laws related to their activities, the government should better consult with business practitioners and entrepreneurs, because so often the laws seemed impractical. Despite this attitude, our interview evidence shows that there is an enduring tendency to conform and at least formally adapt to a new legislative reality, though largely at the cost of end customers (see Table 7.4).

An important observation related to regulative institutions is that entrepreneurs tend to complain about regulations in rather general terms without providing examples from their lived experience. At the same time, when it comes to practice, it feels like this negative institutionally shared attitude toward regulative burden is exaggerated or even refuted by their lived experiences (see Table 7.6). Although we have been able to find out few cases where entrepreneurs had to abandon their business because of new regulations (e.g. when police reform tightened the enforcement of street trading restriction), these cases were not fatal; it took just a matter of time for the entrepreneurs to reorient their business into a more sustainable one or, in the worst scenario, to change the sphere (see Table 7.5). This result points toward the resilience of entrepreneurs in the face of the regulative burden they encounter in Russia. Specifically, the costs of regulative burden entrepreneurs are faced with in Russia are paid by the end customers, not by the entrepreneurs. This finding

Table 7.4 Regulative institutions

Conformity to impractical regulations at the cost of the end customer	
BS16: *These days, the views of retail chains and manufacturers are ignored by law-makers, and legislators alone decide for the whole country how every price should be formed … They make mistakes, then slowly correct them, but in the end, as always, it is the end customer who pays for their mistakes.* BS21: *Legislators don't have to understand all the intricacies of the business, because it is impossible for them. I do this 24 hours a day, and they—20 minutes. It's normal that they do not understand retail, what upsets me the most is that they don't listen to the opinion of the professional players in the market.* MD56: *Today, in my view, the state is the biggest risk for any entrepreneur. Personally, I got used to wake up thinking am I poor already or not yet? Because of legislative initiatives. Especially, in the field of beer … For six years while I was brewing beer, many things happened. In general, the state is an everyday risk situation, with which we got used to live and find ways to resolve. We are preparing for the bad. Just in case if this law* (forbidding plastic bottles for draft-beer shops) *would be accepted, my friends from "Novosibirskprodmash" are developing an alternative solution.*	
Lived experience refuting harsh regulative pressures	*Supporting evidence*
MD47: *So far, I have not felt any excessive demands of any pressure from tax and other authorities.* MD51: *First, there are many empty niches, untilled field; second, there are almost no impediments from the government.* MD54: *I've never felt any repressions from the tax authorities.* MD58: *I've never experienced any problems with the authorities or with the law. I simply do not understand some of the discussion that there are obstacles.*	MD: 3, 4, 5, 12, 24, 37, 44, 47, 51, 54, 56, 58 BS: 3, 5, 9, 10, 16, 46

Table 7.5 Normative institutions

Normative constraints towards growth and visibility
MD4: *In Russia, the business can be done. I do not know, however, up to what volumes. Perhaps, my business has not yet reached the volumes that we would be interesting for a variety of parties, but in principle, they allow me to work.*
MD20: *…I think no one bothered me much so far, and I hope that after your programme, too, no one will…*
MD47: *When a business crosses some point in size and becomes interesting for those people who have the right to decide something in the bodies, perhaps there could be some questions and difficulties. At my level, it is easily possible to do business in Russia.*
Normative constraints towards political and sectoral activity
MD 9: *I think, if you do not meddle in politics and don't participate in dubious projects … then the business can be conducted in Russia*
MD 45: *It's rather easy to do business here. If you do not cross the line interfering with the government and not striving for political power, they will be loyal to you.*

can serve as an explanation for the insignificant impact of regulative institutions on small- and medium-sized enterprises' (SMEs) performance in Russia reported elsewhere (Volchek et al. 2013). Other studies highlighted surprising persistence and resilience of entrepreneurs and their ventures through macroeconomic crises (Davidsson and Gordon 2016) and even danger of war (Bullough et al. 2014). Thus, we can infer that the persistence can be regarded as a special quality attributable to (some) entrepreneurs. This capability to anticipate, adapt and adjust their business can be considered as a dynamic

Table 7.6 Institutional escapism

Exemplary evidence
MD48: *I have another hobby I want to bring to life, it is moonshining. I am planning to open up a factory for the production of spirits. The only thing is it is impossible in Russia, because the licensing is very complex, so in the near future the plan is to start in one of the neighbouring countries.*
MD21: *I think that even in IIDF*[a] *they understand that the realities of Russian law are such that it is very difficult to enter the company and somehow arrange the relationship between the shareholders. It is just impossible to do so in the way that everyone would be satisfied and without dramatic ending. Today, of course, it is better to work under English law jurisdiction, but I hope all this will change for the better in one, two of three years.*

[a]The Internet Initiatives Development Fund (IIDF) is a Russian venture capital fund established by the Agency for Strategic Initiatives as suggested by Vladimir Putin. The Foundation invests in technology companies in the early stages of development, develops a network of start-up accelerators, and is involved in the development of methods of legal regulation of the venture industry.

capability of entrepreneurs that live through constant institutional changes in their sectors of economy (Teece et al. 1997).

Our interviews have not thrown up any first-hand evidence of severe regulative pressures ultimately affecting entrepreneurial actions. In particular, instead of revealing their own experience, entrepreneurs were referring to vicariously learned knowledge (Kim and Miner 2007) based on exceptional cases and some gossip-like stories (i.e. social discourse). In a few cases where there were some minor tensions with regulatory bodies and negative complaints, entrepreneurs were able to respond in a conforming manner rather quickly and did not experience any dramatic consequences regarding their entrepreneurial actions (e.g. BS 10). Furthermore, we have to admit that our impressions concerning these minor tensions with the regulatory environment is that if these entrepreneurs were more informed about laws, rules and practices before they made their actions, they would have easily avoided these problems. Additionally, we have found evidence that even functioning entrepreneurs sometimes lack rather basic knowledge related to establishing and operating a new business (i.e. *cultural-cognitive institutions* as conceptualized by Busenitz et al. 2000), as can be seen from the dialogue below:

MD4: *Recently I have been trying to register a new enterprise in Moscow and it is just terrible. The prices for registration services are extremely high; it cost me ten times more than in St. Petersburg. Ten times!*

Interviewer: *Is it a simple limited company (LTD)?*
MD4: *Yes.*
Interviewer: *Actually, you can do it free of charge.*
MD4: *Oh really? Where?*

We can interpret the above story in a way that the knowledge about more efficient ways of establishing a new business has not been institutionalized so far or, in other words, has not yet become a part of a shared social knowledge. Accordingly, we may infer that the cultural-cognitive dimension of the institutional environment collides with regulatory institutions, thus inhibiting the efficiency of entrepreneurial activity in Russia. However, the observation that the end customer tends to pay for this inefficiency, owing to low-level industry-based competition, eventually gives an entrepreneur a chance to survive and succeed. Likewise, there is also evidence that normative institutions may also undermine the proper functioning of the regulatory framework. An interesting example of how recent changes in the formal institutional environment affected entrepreneurs in Russia occurred in 2013, when the government decided to double the amount of tax-like pension and social insurance contributions. The consequence of this change was that more than 500,000 individual entrepreneurs closed their legal entities and presumably converted their businesses to black and gray markets (Safonov 2014). Notably, this kind of socially acceptable isomorphic collective behaviour reflects the institutionalized practice of converting businesses to informal economy as opposed to abandoning it (DiMaggio and Powell 1983; March and Olsen 1989). One of our interviewees provides another similar example of how regulatory changes may activate previously latent but easily awakened norms a of going to, and operating in, the black market:

BS 6: I am sure that sooner or later gambling business will come back to Russia. In fact, it has never been closed. It has had to adjust, and the government eventually has got a huge illegal industry.

The influence of the normative and cognitive institutional pillars, rather than regulatory ones, on entrepreneurial intentions and behaviour is examined in the next sections.

Cultural-Cognitive and Normative Institutions for Entrepreneurship

Regarding the cultural-cognitive pillar of the institutional environment, our data leads us to several important considerations. Different cultural values make people different in what is important for them, particularly in relation to their entrepreneurial intentions; people from different cultural backgrounds put emphasis onto different things. For example, in more universalistic societies, the law is the law and if pursuing certain entrepreneurial opportunities is forbidden, then people would most likely abandon their intention. In the particularistic society like Russia, the laws themselves are not so straightforward and entrepreneurs may find a way to go around or stay unnoticed (Hendley 2012). The non-universally inclusive nature of the regulatory institutional environment (e.g. arbitrary and non-mandatory provisions on law enforcement) was mentioned many times in our interviews and several entrepreneurs even referred to the same quotation by the famous

Russian nineteenth-century satirist and, ironically, civil servant Mikhail Saltykov-Shchedrin (cited in Barber et al. 2008):

> The severity of Russian laws is alleviated by the lack of obligation to fulfil them.

Having in mind these particularistic social norms and values shared by the society, putting too much effort on building a regulatory environment at the cost of informal institutions seems to be inefficient. Maintaining costly high-standard and favourable legal framework pays off only where it actually works in practice.

Another interesting observation concerns the norms related to the quality of produced goods and services. While the times when the Russian market was starving for numerous goods and services have passed, preliminary evidence from our interviews shows that compared to various other countries in most industries, there is low (or even no) competition for goods and services of proper quality. From the institutional perspective, this finding reflects the absence of normative institutions supporting and incentivizing delivery of high-quality goods and services. There are common idioms and jargons describing this kind of attitude such as "people have it", "grannies eat it" or "people like it" in relation to any low-quality, but mass-market and commercially viable product, from music and programs to margarine and political agenda. This suggests that a majority of people here are thought to be unsophisticated and passive in terms of demanding for better quality—an attitude which, taking a historical path dependency perspective, could be traced back to the Soviet period when people did not have any choice in what they consumed. Now that they are overwhelmed with a variety of goods and services, they are presumably still in the initial stage of framing their preferences for quality:

MD11: People are still fine buying lower-quality goods, but when they start asking for quality then it will be different.

However, as the next quote shows, there appears to be a quality-demanding segment comprising people of above-average income who had the experience of a proper level of service elsewhere:

MD45: Even when I come to the official BMW dealer in Moscow for ordinary maintenance, I have to give some money on top to ensure that they will put effort to make everything fine. That is because so often I had left the dealer not on my wheels, with different rugs, etc. I just want to be served OK. There is no need for wow-effects, no need to be surprised. What I need is a service that I pay for, nothing more! Just do not screw

> *it up, come on time, call on time, deliver a product, call to find out if everything is in order—this level of service would make people said, 'Wow, it's unbelievable, how come you are so good?'*

In our interviews, we have been able to find multiple experience-based evidence of people showing this kind of attitude, which suggests that there are many niches where improved quality of goods and services would easily convert currently latent demand into a viable business. Also, many times in the interviews, entrepreneurs have expressed a simple heuristic that in order to stay safe from possible interventions of various powerful actors, it is better to remain small and not stand out too much. Along with these normative constraints toward growth and visibility, there are also similar working norms related to being politically active and doing business in some particular sectors of the economy (Table 7.5).

Notably, we have not found any practical experiences of entrepreneurs sharing their own real-life stories of how growth and visibility made them more exposed to opportunistic attention from the authorities. Table 7.5 also highlights the dissonance between real experience and institutionally shared opinion, where an entrepreneur presupposes what could happen based on some common knowledge, without providing their own lived experience.

Notably, the evidence of growth-constraining attitudes and norms was found in both samples of interviews, and restrictions on political and sector-specific activities, mentioned in the second set of interviews, were extended to additional spheres. Whereas previously the restrictions concerned mostly the oil and gas sector of the economy and political activities on the highest levels (e.g. the Mikhail Khodorkovsky case), the second set of interviews revealed the expansion of this institutional norm to other sectors of the economy (e.g. related to national informational security) and increased opportunities for local officials to intervene in local enterprises. Hence, our analysis points to the development or expansion of normative institutions constraining entrepreneurial actions in particular sectors of the economy and increased political pressure.

Experience-Based Country Institutional Profile for Entrepreneurial Internationalization

A comparison of internationally active entrepreneurs with national and local ones allowed us to highlight several important differences. While the cohort of domestic entrepreneurs featured both necessity- and opportunity-driven entrepreneurs rather equally, international entrepreneurship in our sample predominantly implies opportunity-driven motives. Furthermore, international entrepreneurs seemed to talk more about the competitive characteristics of their offerings than about regulatory constraints and obstacles.

The perception of the harsh domestic institutions may eventually push the firm to internationalize and search for internationalization assistance from abroad. As was the case with an entrepreneur who had to start a private school because he was unable to realize his idea within rigidly regulated public schools, negative "push forces" from the regulatory environment may lead entrepreneurs to establish a business abroad (Table 7.6).

The above-mentioned tendency of *institutional escapism* to mitigate effects of poor institutional contexts have been associated with countries marred by significant voids in their home country institutional contexts (Witt and Lewin 2007; Yamakawa et al. 2008). Given that internationalization due to institutional escapism has negative consequences on the national economy and leads to brain drain, the government should strive to keep these ventures within the legal boundaries of the country, by providing opportunities for efficient international operations.

It is important to note that general entrepreneurship and SME support programs were identified at multiple times during the interviews to have a positive impact on venture creation, while internationalization support agencies or practices were never mentioned. This may stem from the fact that Russian formal institutions do not provide much support for internationalization, or that entrepreneurs, driven by informal institutions, do not bother to know about available support, or feel better avoiding it. Hence, they apparently see no need to use national support organizations (Bell 1997) or consider primary information for the market to be more beneficial (Seringhaus 1987).

Conclusions and Further Research

Existing research on institutional theory in the fields of entrepreneurship (Bruton et al. 2010), international business (Jackson and Deeg 2008) and its intersection—international entrepreneurship (Szyliowicz and Galvin 2010)—lacks studies which focus on informal (normative and cultural-cognitive) dimensions of the institutional environment. This study aimed at comprehensive analysis of practically relevant institutional factors that affect major entrepreneurial decisions such as venture creation, growth and internationalization. Through the course of our analysis, we were able to examine elements of institutional environment relevant to particular entrepreneurial intentions, as functioning entrepreneurs perceive these.

The main contribution of our study pertains to building a general model for entrepreneurial cognition based on experience and institutions, and deepening the existing knowledge of the influence of different institutional combinations on entrepreneurship and internationalization (Fig. 7.1).

The aforementioned framework was gradually developed through synthesizing knowledge from evidence obtained through all sections of our analysis. The model implies that before making a particular decision (venture creation, growth and internationalization), entrepreneurs evaluate previously identified opportunity through the prism of their own experience as well as against expectations from the institutional environment. This mechanism of cognitive assessment embodies an interesting duality between institutionally shared opinions and the experiential knowledge of entrepreneurs, if the latter is present. Supported by the analysis of 213 interviews, the study proposes that the impact of institutional pressures on entrepreneurial cognitions is moderated by entrepreneurial experience and level of industry-based competition. In other words:

P1: The more experience an entrepreneur has, the lower the negative impact of institutional pressures on their cognitions regarding intentions to create, expand and internationalize their venture.

P2: The higher the level of industry-based competition, the lower the negative impact of the institutional environment on entrepreneurial cognitions regarding intentions to create, expand and internationalize their venture.

Implementation of policies, based the above propositions, should reduce and alleviate the negative consequences of domestic institutional environment,

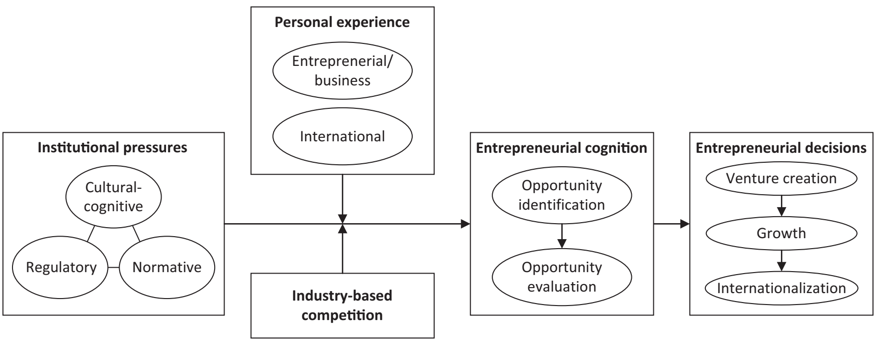

Fig. 7.1 An integrative model of entrepreneurial cognition

thus triggering new venture creation and entrepreneurial internationalization. Likewise, the study shows that the negative impact of institutional environment largely stems from informal institutions such as unsupportive social pressures toward entrepreneurship and various normative and cultural-cognitive constraints. Additionally, our analysis revealed the intertwined effects of institutional factors, thus emphasizing the need to study institutional environment as a set of configurations ("bundles") rather than trying to separate the impact of certain institutional factors or dimensions. Besides, the current lack of trust between entrepreneurs and the government is a high-priority challenge that needs to be overcome in order to enhance the efficiency of policy implementation and improve regulatory framework. The fact that governmental support targeted at internationalization activities was never mentioned may also be due to the lack of trust and deliberate attempt to hide from the "radar" until ventures become more independent (institutional escapism).

While our phenomenological analysis does not allow us to generalize the results to other countries in the statistical sense, we have shown that a more nuanced, context-sensitive, approach to institutional forces that may influence entrepreneurs' intentions to create, grow and internationalize their ventures brings deeper and more practice-oriented understanding. By providing examples on how formal institutional forces interact with the informal, and eventually turn toward an opposite direction rather than what was expected on the basis of "theory", we warn policy-makers from transition economies like Russia against any simplistic and partial benchmarking. Alternatively, they should carry out more tailored and nuanced measures that fit a particular country context. In this respect, research may further look into different configurations of institutional factors to identify congruent patterns valid across countries (Puffer et al. 2010). Despite the fact that discussions of specific political–economic reforms go beyond the boundaries of this study, we have been able to show that policies directed at the promotion of entrepreneurial experience, increased competition and supportive informal institutions could assist in facilitating institutional changes in Russia. More harmonized development of the institutional environment that encompasses particular combinations of factors conducive toward entrepreneurship would help to unleash the currently hampered potential of the Russian economy.

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Part III

Innovation Pathways: Sectors, Knowledge Flows and Entry Modes

8

The International Expansion of an Art Museum: Guggenheim's Global–Local Contexts

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Introduction

During the past few decades, the number of museums in the world has grown exponentially; 95 percent of existing museums postdate World War II (Macdonald 2006). Since the "blockbuster" exhibitions of the 1970s, this "museum phenomenon" (Fyfe 2006, p. 40) has gained an increasingly global reach. Today, a handful of museums such as Guggenheim, Louvre, and Hermitage have local affiliates in different countries. Moreover, contemporary art organizations are also business organizations where museum managers attempt to run their museums profitably across countries. The challenges that non-profit art organizations encounter, as Doh and Lucea (2013, p. 187) note, are "strikingly similar to those faced by MNEs". Therefore, it is important to study non-profits as "multinational organizations in their own right" (Doh and Lucea 2013, p. 187; see also Devinney 2013; Kolk 2016).

In the light of these global developments, the internationalization of art museums represents a largely under-explored terrain in the international business (IB) literature (Rectanus 2006). We believe that this context is not only interesting but also theoretically important as it allows creating connections to other streams of literature such as institutional theory. Despite the potential of arts to create a universal language, its interpretation and cultural

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significance remain a local matter (Geertz 1976). Art and art museums also reflect national sovereignty and have strong symbolic value (Keane 2004)—they strongly resonate with and reproduce local institutional context. These dialectics and tensions between local organizations and institutions and global businesses are manifested through local negotiations and accommodation of foreign entrants. Studying these negotiations in their particular institutional context has the potential to provide new facets to internationalization processes such as international market entry. We believe that the IB literature has much to offer for a richer understanding of the contemporary museum field. Thus, we set out to investigate *how the international market entry of an arts museum is negotiated between its head office managers and local actors*.

Inspired by the narrative approach, we undertake an exploratory interpretive study of the internationalization of the (Solomon R.) Guggenheim Foundation. The Guggenheim Foundation epitomizes an extreme case: the global museum with its head office on Fifth Avenue, New York, and own "universe of branches" (Rectanus 2006, p. 381) in Bilbao, Venice, and, in future, in Abu Dhabi. Despite the obvious success of Guggenheim, symbolized by the "Bilbao's Cinderella Story" (The New York Times 1999), its path to international growth has been rocky, as we will show in this chapter. Guggenheim was the first museum to use franchising—a contentious operation mode in the arts sector—which led critics to accuse Guggenheim of contaminating local art with global business. Scholars have even suggested that Guggenheim is a multinational corporation, albeit an atypical one, subject to the same demands of local adaptation and global standardization as any multinational (Plaza and Haarich 2015). We study how ongoing international market entry and the plans for the physical building of the Guggenheim Museum in Helsinki, Finland, were negotiated in real time between the representatives of Guggenheim's head office in New York and the local actors in Helsinki. Our empirical material mainly builds on in-depth interviews and a wealth of secondary data, including news stories on the internationalization of the Guggenheim Foundation.

Our study of the Guggenheim Foundation as an international organization makes two contributions. First, it expands and refines IB theory by challenging the dominant view of the internationalization process as a forward-progressing linear movement (see also Hurmerinta et al. in press; Welch and Welch 2009). We analyze the nature and causes of this non-linearity as reflected in the stories told by local actors and representatives of Guggenheim's head office. In doing so, we respond to the recent calls to consider the influence of field-level characteristics on institutional complexity, meaning multiple incompatible frameworks for action, and in internationalization as experienced by different types of organizations (Faulconbridge and Muzio 2016; Greenwood et al. 2011, 2014). In doing so, we continue the fruitful dialogue with institutional scholars on how institutional complexity faced by a multinational organization shapes organizational action (Saka-Helmout et al. 2016; Kostova et al. 2008).

Second, we focus on the local negotiations performed by Guggenheim that give voice to key institutional and political actors in the local host country whose views and opinions are rarely heard in IB research (Gertsen and Søderberg 2011; Haley and Boje 2014; Jack et al. 2008). This allows us to uncover conflicting stories about the museum's international market entries. By extending previous studies on internationalization beyond boundaries of the firm, we promote a more inclusive and expansive view on IB (Toyne and Nigh 1998). We believe this is of value for both non-profit and multinational enterprise (MNE) managers (Doh and Lucea 2013).

Non-linearity in the Internationalization Process

Previous research on the internationalization process commonly conceptualizes it as a unidirectional, linear, and forward-oriented path. Welch (2016, ns[1]) writes that the general pattern of internationalization has been described as a "movement over time from lower commitment, lower involvement forms of operation (e.g. licensing and exporting via intermediaries) to higher commitment and higher involvement forms (e.g. sales subsidiaries and eventually production subsidiaries)". Vissak and Francioni (2013), among others, challenge this traditional view by discussing non-linear internationalization. They argue that firms may exit and re-enter host markets, sometimes even the same host country, several times. Their notion of non-linear internationalization integrates both de-internationalization (Benito and Welch 1997) and re-internationalization decisions (Welch and Welch 2009) in order to capture the forth-and-back moves of an organization over time.

Much of the research on de/re-internationalization has been conceptual (Benito and Welch 1997; Turcan 2013; Turner 2012; Welch and Welch 2009) with few empirical contributions (e.g. Vissak and Francioni 2013). This stream of research has attempted to explain why de/re-internationalization occurs. The underlying reasons largely centre around international experience and knowledge, stage, and type of commitment (both physical and psychological resources) to international operations (Benito and Welch 1997; Welch and Welch 2009). Welch and Welch (2009, p. 570) underline the importance of

[1] "ns" is used here to mean "not specified".

an organization's "experiential knowledge, international networks, managerial skills and attitudes to internationalization", which make up its so-called international heritage. They argue that the international heritage forms the platform on which subsequent re-entry decisions are built, because it creates an attitudinal legacy and raises expectations toward international operations. In this regard, international heritage refers to "the intangible dimensions that remain despite tangible resources and physical presence having been withdrawn" (Welch and Welch 2009, p. 569).

Previous research suggests that non-linear internationalization is not only caused by internal but also by external factors (Benito and Welch 1997). Re-entries and reversals have been explained by referring to financial considerations such as low profitability and high costs caused by economic fluctuations. While partial withdrawals can be viewed as normal activities of an organization, full reversals of international activities in a given host market are more puzzling. This is accentuated by the fact that commitment to international operations tends to build up over time; even in case of negative feedback from host markets, it becomes difficult to break the cycle of escalating commitment. Committed decision-makers typically want to move the internationalization process forward and not reverse it. Thus, de-internationalization is often an outcome of a change in the top management, because newly appointed managers are psychologically free from past commitments. As Benito and Welch (1997, p. 14) argue, internationalization in itself "can be viewed as a barrier to de-internationalization", underscoring this escalating commitment. Decision-makers' experiences and interpretations of past internationalization become central in understanding subsequent re-entries and withdrawals (Benito and Welch 1997; Turner 2012; Welch and Welch 2009).

Turner (2012), however, criticizes past research on de-internationalization for overemphasizing the role of management. He offers a co-evolutionary perspective suggesting that international trajectories are better explained as an interaction between managerial intentionality and the external (e.g. institutional) pressures of the host country. His co-evolutionary framework spans across multiple contextual layers and adopts a holistic view on non-linear internationalization processes. Yet, we do not fully understand how (and why) managerial intentionality, international heritage of the organization, and broader institutional forces interact to influence internationalization trajectories. Next, we detail our use of the narrative approach to creating a theorized, socially constructed storyline of the non-linear internationalization process of an arts museum.

Research Strategy

Research Setting

The internationalization of the Guggenheim Foundation is a case of expansion, but the process was not straightforward or linear. In order to capture the meandering story and its turns, we use narrative theory to frame the process (Haley and Boje 2014). Inspired by Greimas' actantial model (Greimas 1966; Gertsen and Søderberg 2011), we study the narrative construction of Guggenheim's expansion with the help of six central actants in the narrative. This method allows us to discern the various perspectives associated with importing the Guggenheim Foundation to Helsinki.

The Guggenheim Foundation has revolutionized the world of museums through its significant international presence. The Foundation's mission is to promote the appreciation of art, architecture, and other manifestations of visual culture across cultures. The board of trustees (often significant contributors of funds) exercises the highest authority over the Guggenheim Foundation, including major decisions to internationalize. The operations, in turn, are led by the executive cabinet of directors, which manages the activities of the Foundation, including the global strategy and network of museums. The Foundation directly owns and operates the Guggenheim Museum in New York and the Peggy Guggenheim Collection in Venice. It oversees the Guggenheim Museum Bilbao, which is a public–private partnership with the Basque government. Plans are under way to open a sister organization in Abu Dhabi (The Guggenheim Foundation 2014), but these have run into difficulties due to labour rights issues faced on the construction site. Our focus is on the negotiation process around the Guggenheim Helsinki, a museum that would focus on Nordic and international architecture and design.

Data

Our primary data source is 47 in-depth interviews conducted in Helsinki and Bilbao during January 2014 and December 2015. Informants include representatives of the Guggenheim Foundation as well as local stakeholders, ranging from city and governmental officials and politicians to architects, artists, museum managers to researchers, and journalists. Some of our interviewees acted in dual roles, for instance, as representatives of both the Guggenheim Foundation and local independent support foundations, or as politicians and city officials. The interviews were open ended and centred on the respondents' experiences of the key actors and their roles in the process, events and their progression, and the main challenges in addressing them. In addition, we conducted 20 hours of non-participant observation between June 2014 and June 2015 in the series of events organized as part of the architectural competition for the Guggenheim Museum Helsinki.

We also collected a wealth of secondary data, including 138 news stories on the international operations of the Guggenheim Foundation in the *New York Times*, from 1988 to 2015, and 466 news stories on the Guggenheim Museum Helsinki in the main national newspaper, Helsingin Sanomat, from 2011 to 2015. This material provides a complementary perspective on the key events, their precise temporal sequencing as well as additional voices and narrators of the internationalization story. Finally, we scrutinized a wide variety of publicly available material available through the webpages of the Guggenheim Foundation, the Guggenheim Helsinki website, and the Guggenheim Helsinki Supporting Foundation.

Narrative Analysis

A narrative analysis of the internationalization of the Guggenheim museum assists us in gaining a deeper understanding of the ways in which a few individuals derive meaning from events. The narrative plot entails trials and crises, these calling for choices, decisions, actions, and interactions, leading to actual outcomes that are often at odds with the characters' intentions (Gabriel 2000). Greimas (1983) developed the so-called actantial model for the narrative analysis of plot structure. In the model, an action may be broken down into six components called actants. Greimas posits six actants, which form three pairs of binary opposition and can be found in most narratives. Subject/object represents a wish for something. Subject is often identical with the narrator, who is trying to reach a goal. Object is the targeted result, something to achieve. Sender/receiver stands for a process of transformation or communication. The sender is someone who gives a task, initiates, or enables the event. A sender sets the subject who should reach the object and the receiver gets the price or benefits. Helper/opponent corresponds to support or opposition related to the task given by a sender. The helper assists the subject in achieving the desired goal; the opponent hinders the same by opposing the subject or by competing with the subject for the object. Figure 8.1 shows our starting point in applying Greimas' actantial model to the internationalization of the Guggenheim Foundation.

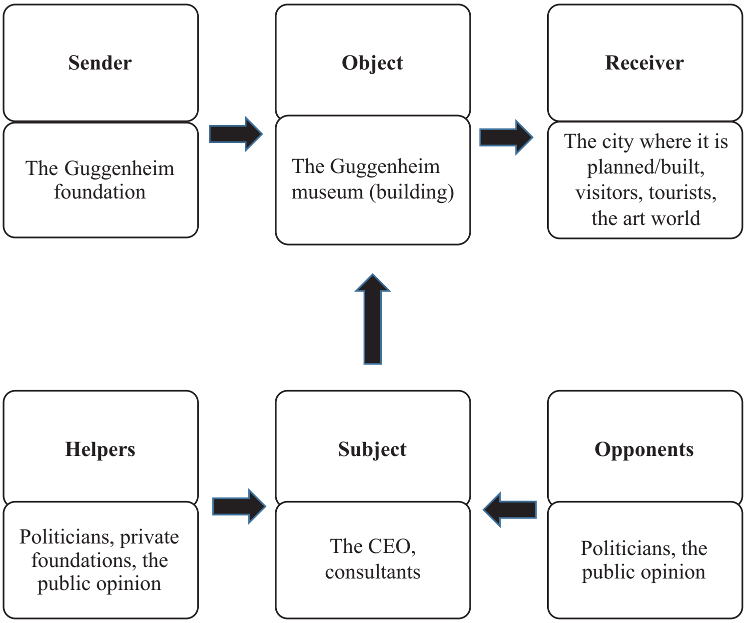

Fig. 8.1 Greimas' actantial model (1983) applied to the Guggenheim Foundation

The way in which the actants are identified typically changes as the story goes on. A sender may change, an object can be redefined, a new helper or opponent can appear, a helper can become an opponent, or an opponent can become a helper. Greimas also provides tools to analyze how the story moves forward, by what he calls "tests", representing transformation in the story: qualifying test, decisive test, and glorification test. According to Greimas, passing one test leads to the next one, but it is also possible to fail the test and thus not to reach the next level. The first test is the qualifying one, which corresponds with competence. The subject—with the aid of helper(s)—proves his/her ability and becomes qualified. The second test is the decisive test, which corresponds with performance. The subject achieves something after facing problem(s) and beating his/her opponent(s). The third test is the glorification one which corresponds with recognition. The hero manages to be recognized as triumphant because of his/her achievement(s). Glorification represents the final solution and provides closure to the story.

Findings: Guggenheim's Multiple Market Entries to Helsinki

The Story Begins: From the Old Continent to the New World

The rise of the Guggenheim family from anonymity to prominence as one of the wealthiest and most influential families in the world is "a classic American rags-to-riches story" (Breiner 1990b, p. 3). In the mid-nineteenth century, the Swiss-born Meyer Guggenheim immigrated to Philadelphia, USA, to escape the persecution of the Jews and started a business as a traveling salesman. In 1881, together with his seven sons, Meyer transferred his business to New York City under the name M. Guggenheim's Sons. Their business soon developed into the world's largest multinational mining conglomerate (Lawson-Johnston 2005). The fourth son, Solomon (1861–1949), was sent to Zurich to study German and business, and after returning he acted as the treasurer of the mining empire (Breiner 1990a, b). Solomon was engaged in a wide range of philanthropic activities and, with his wife Irene Rothschild, became a dedicated supporter of the arts, particularly contemporary art that few Americans seemed to appreciate at the time. Solomon's fascination for non-objective art that came to define modern art in the twentieth century was much inspired by his "confidante", young Baroness and German artist Hilla Rebay (Lawson-Johnston 2005). Rebay became the Artistic Advisor and first Director of the Guggenheim Foundation, a non-profit entity established in 1937 to manage the art collection, including paintings of Kandinsky, Chagall, and Picasso. Peggy Guggenheim (the niece of Solomon) donated her entire collection of abstract and surrealist works housed in the Palazzo Venier dei Leoni in Venice in 1976 to the Guggenheim Foundation. As the location of the donated collection happened to be in Italy, this was the first international outpost of Guggenheim—albeit an unplanned one. It was not until 1988, however, that a significant turning point took place in terms of growing Guggenheim as an art enterprise of truly global dimensions (Lawson-Johnston 2005).

Krens' Era and the Growth of the First Global Museum

In January 1988, Thomas Krens, known as an aggressive museum administrator, was appointed the new director of Guggenheim. He was the architect and mastermind of the ensuing aggressive internationalization strategy. Mr Krens reasoned that since Guggenheim was at the time only the fifth or the sixth most important art museum in New York, it should gain the number one position globally rather than compete at home. The Foundation was also in desperate need for cash flows. For instance, the restoration of the Frank Lloyd Wright Museum building on the Fifth Avenue was estimated to cost US$14 million and in 1988 the deficit of the Foundation was US$2 million on an operations budget of US$11 million (*New York Times* 1990). Peter Lawson-Johnston, a trustee and the then president of the board, explained that Mr Krens' "*energy, intelligence and international outlook are qualities which make him eminently suitable to the formidable tasks ahead*" (*New York Times* 1988, ns). Thomas Krens with an MBA in management from Yale, also known as the "*Clint Eastwood of the art museum director's world*" (*New York Times* 1988, ns), argued that growing the Guggenheim's global constellation of museums would create economics of scale as the permanent collection could be rotated between the branches. A stronger brand would also attract high-profile collaborators around the globe, just like multinational corporations can increase efficiency and learning through integration and coordination across their networks (Plaza and Haarich 2015). The first foreign venture was announced in 1989 to be in Salzburg (Austria), but later political controversies ended the project. The wide publicity of the Salzburg project attracted many proposals, among these one from Bilbao, Spain.

Initially, Guggenheim was not enthusiastic about Bilbao—in fact, this polluted city with high unemployment and aggressive Basque Nationalists was initially considered as "*the very last option*" (Interview data). However, as all other options failed and the Province of Biscay had fiscal autonomy, simplifying decision-making processes, Bilbao became an attractive option. Soon after the opening of the titanium-clad museum building, the Guggenheim Bilbao became the symbol of economic and urban renewal. In its first year, 1.3 million visitors visited the museum (Plaza 2006), tripling even the most optimistic projections of the Guggenheim Foundation (Lawson-Johnston 2005). During a typical year, two-thirds of the museum visitors are non-Spanish who generate hundreds of millions of euros for the local economy. This transformative effect on the entire region was soon nicknamed in the media as the "Bilbao effect", and it captured the attention of policy-makers all around the world. As a result, the Guggenheim Foundation was approached by a number of cities from Tokyo and Hong Kong to Vilnius and Rio de Janeiro to explore the opening of new Guggenheim satellites (see Fig. 8.2).

However, some of these initiatives were buried due to political opposition or the skepticism of local arts communities. Later, the temporary branches in Las Vegas and Berlin were closed down. At the same time, the very idea of

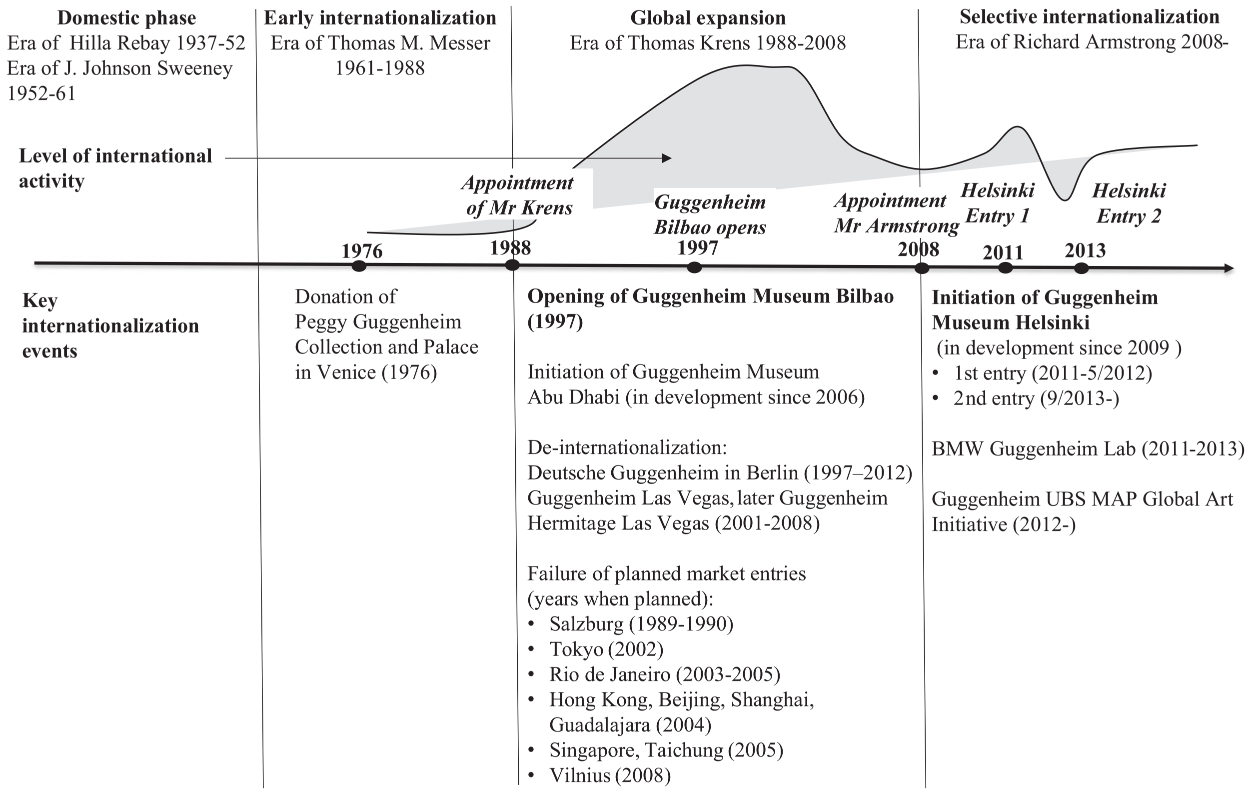

Fig. 8.2 Process of internationalization of the Guggenheim Foundation

treating the museum as if it was "*a global corporation* or *an empire, with colonies in Spain, Germany and Italy*" (*New York Times* 1998b, ns) was increasingly criticized. Also, the adverse economic conditions following the 9/11 terrorist attack led to a deficit in the budget for the New York museum. The criticism of Krens' expansionist strategy culminated in his resignation. The expansionist era of Guggenheim had come to an abrupt end.

In the Greimas' story plot and actant model, Krens was the "Subject" in the expansion; the foundation was the "Sender". "Krens' era" was characterized by the classic hero-story. He conquered first the qualifying test; he was competent, charismatic, and had a large network. He then overcame the decisive test; he made the decision to build a museum in Bilbao. Finally, he overcame the glorifying test as the Bilbao museum was a success beyond expectations. His former Opponents, for example, Public opinion in Bilbao, became Helpers. However, the global expansion was also contested; the international expansion was very expensive, and when the museum's fortunes changed, Krens fell from grace.

Armstrong's Era: Returning to the Idealistic Roots of the Guggenheim Foundation

In September 2008, the Guggenheim Foundation appointed Richard Armstrong, director of the Carnegie Museum of Art, as its new director. The president of the Guggenheim board explained: "*We were looking for someone with a passion for art who understood that the New York museum is at the center of our universe*" (*New York Times* 2008, ns). Armstrong was keen on bringing back the idealism that made Guggenheim world famous. He thus became the new Subject of the story. The new strategy meant increased selectivity in the Foundation's internationalization. While during Krens' era, internationalization was tightly linked to building new museums, under Armstrong, rotating Guggenheim labs were launched. In fact, since this leadership change, Helsinki has been the only city with which the Foundation has negotiated about a new museum building. The plan was also negotiated with the board of the Bilbao Museum, as it had the right to veto any new museums in Europe.

Mr Armstrong explains that "*Helsinki is the best! I want to finish the Abu Dhabi project and get one museum in Finland. After that the museum network is finished on my part*" (Helsingin Sanomat 2012, ns). Vicinity to Russia and the broader geopolitical context was strong in the storyline constructed by local actors of a Guggenheim Helsinki: "*Helsinki is interesting in its context.*

Finland would count little without its big neighbors, that is, Russia, Sweden and Germany" (Interview data). In this way, the proximity to Russia was both a Receiver, in having potential visitors, and a Helper, in giving Armstrong arguments for this case of expansion.

The First Attempted Entry: From Behind-The-Scenes Preparation to a Cultural Battle

In a press briefing organized at the Helsinki City Hall in January 2011, the director of the Helsinki Art Museum, Janne Gallen-Kallela-Siren, announced the collaboration between the City and the Guggenheim Foundation. This announcement was preceded by intensive preparation within a small inner circle: Mr Gallen-Kallela-Siren, the visionary US-educated initiator of the Guggenheim Helsinki; Carl Gustaf Ehrnrooth, Finnish art collector and member of the Board of Trustees of the Guggenheim Foundation; and Jussi Pajunen, the Mayor of Helsinki. At the announcement, the Mayor said that he had begun talks with the directors of the Guggenheim head office more than a year earlier, inspired largely by the success of Guggenheim Bilbao. However, these talks were kept under the radar based on the mayor's political assessment of the situation. These three men were the strongest Helpers during the first entry.

The announcement of the initiative caused excitement and both parties assured their commitment. The headline of *Helsingin Sanomat* (2011, ns) read: "*Helsinki wants Guggenheim*" and "*Helsinki outstripped Taipei, Rio and Guadalajara*". However, the atmosphere of excitement and positive energy turned into hostility and fear when the feasibility study was publicized one year later. The study suggested that a Guggenheim Helsinki would benefit greatly both the Guggenheim Foundation and the City of Helsinki (The Guggenheim Foundation 2011), but the critics loudly pointed out in the *Helsingin Sanomat* that the figures of the financial model were unrealistic and that the Guggenheim Foundation was to receive a US$30 million licensing fee for a 20-year period (see Fig. 8.3 for the increase in the amount of news stories).

The Guggenheim Foundation's managers felt that the Finnish press was trying to find all possible faults and threats, and accused the local media of spreading misinformation. In contrast, many local observers actively constructed a narrative about the unwillingness of the representatives of the Foundation to provide accurate information. A quote from one media source illustrates this well: "*At the beginning they were very arrogant and said*

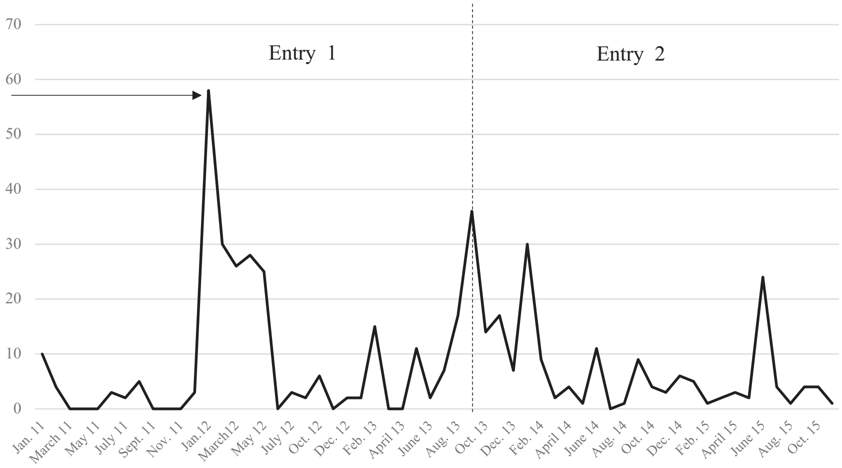

Fig. 8.3 The number of new stories on the Guggenheim Museum Helsinki in the local newspaper *Helsingin Sanomat*

that we don't answer any questions at all, and I didn't get a chance to talk with them". This information void was considered damaging to the legitimacy of the Foundation, particularly among the cultural stakeholders in Finland, a fundamentally open society. As a result, the museum project was increasingly labeled non-transparent and led by a small inner circle of business men. Also, the feasibility study was interpreted by the critics as promoting a "take-it or leave-it" approach. Yet, the supportive voices for the Guggenheim Helsinki project contended that the Foundation invited conversation "*let's talk about* [our suggestion]" (Klaus, city official). Regrettably, the media, of which the majority started out as Helpers, had turned into Opponents.

This inconsistency in the perceptions was interpreted by some to reflect underlying ideological tensions and contradictions prominent in Finnish cultural life:

> *Having experienced the 1970s myself, I sensed already at the launch event [at the Helsinki City Hall] the rise of a kind of general democratic movement, a sort of anti-Americanism, which has been part of this initiative all the time.* (Interview Data)

According to these voices, the dispute about Guggenheim resonated with the nationalistic and protectionist tone of the Finnish cultural field, which they associated with the political left. For example, in the above quote, the interviewee makes a reference to the Cold War period when describing how the local Opponents framed the USA as an imperial power. The Opponents equated Guggenheim with business and money-making, which was seen as detrimental to arts. The Opponents' narrative of the monolithic external threat was described as emotionally loaded by the supporters: "*It is very emotional—a conversation which is not based on rational argumentation, but rather on emotions—one where one must take a position either for or against without the ability to argue [and justify]*" (Interview Data, government official).

In April 2012, perhaps unsurprisingly, the board of the City of Helsinki voted against proceeding with the museum proposal. The critics claimed that, according to the proposal, Guggenheim would assume decision-making power, but the Finnish taxpayers would carry the risks and costs. Such criticism could not be ignored at a time of significant budget cuts in Finland, when investments into culture in general declined. The proponents (the Helpers) of the Guggenheim Helsinki museum, on the other hand, argued that the project was hostage to a power struggle between the conservatives and the greens over the post of the Helsinki Deputy Mayor. The potential Helpers, thus, turned into Opponents. According to an observer, one of the reasons for this was a cultural distance between New York and Helsinki: "*the Americans from New York arrived and they showed off … The Finns didn't feel very comfortable*" (Interview Data).

What the different actors agreed on, however, was that the Guggenheim Foundation miscalculated the political power of the Mayor in Helsinki. The highest decision-making body of Helsinki is the City Council consisting of 85 members elected every four years. This is very different, for instance, from New York, where the mayor holds major decision-making power. Later, Mr Armstrong commented that Guggenheim was, indeed, surprised and unprepared to deal with the politicized nature of the cultural funding in Finland: "*The public funding in our budget in the US is under one million dollars [only a couple of percent], so we hardly mess with politicians*" (*Helsingin Sanomat* 2013, ns). Guggenheim knew they needed the local funds and subsequently found out that they had to get the politicians on their side as Helpers in order to succeed.

The devastating vote caused some self-reflection among the Guggenheim Foundation's managers: "*We were too naïve and too American at the beginning*" (*Helsingin Sanomat* 2013, ns). The Foundation had held most discussions with the City of Helsinki and counted on the city to reach out to the Finnish state, another key stakeholder of the museum project. Also, the previous Hero-story of Bilbao had created a pre-narrative of how things were supposed to proceed. Hence, the level of collaboration among the different parties came as a surprise to the representatives of the Foundation. This was the Subject's narrative in understanding why the potential Helpers had turned into Opponents. One project participant argued that the principles of democracy were hurt: "*My interpretation is that the central problem was the lack of a democratic process and through that dearth of legitimate civil debate*" (Interview data, Guggenheim local).

However, the Guggenheim Foundation did not give up the idea of the Helsinki museum, but focused on shaping a better-managed re-entry. Mr Armstrong as the Subject in the narrative had in the first entry succeeded in the qualifying test—there was enough support for Guggenheim to start planning a museum in Helsinki. The problems started at the decisive test, when he mistook who the Opponents were and the power they had. He also unintentionally turned some Helpers into Opponents. The glorifying test and success were still far away.

The Second Attempted Entry: Re-engaging, Disengaging, and Reframing the Guggenheim Legacy

Guggenheim's failed entry to Helsinki, caused by misjudgment of the Opponents' arguments and power and the Helpers' powerlessness, led to a mix of *re-engaging, disengaging,* and *reframing* strategies in the second entry. In the spring 2013, the negotiations between Guggenheim and the City of Helsinki were resumed. This time, the Guggenheim Foundation engaged the communications agency, Miltton Group, to get independent political and press advice to avoid further cultural clashes. Additionally, Miltton coordinated private fundraising efforts for Guggenheim Helsinki. In September 2013, the Guggenheim Foundation presented a revised proposal for Guggenheim Helsinki. In this proposal, the Foundation agreed, for instance, to reduce its annual operation fee by 50 percent from two million euros (EUR) to one million euros (The Guggenheim Foundation 2013a). In the announcement event, Mr Armstrong assured that Guggenheim remains "*steadfastly committed*" to Guggenheim Helsinki and expects "*that a full and frank discussion will help move this important project toward realization*" (Guggenheim Foundation 2013b). This was Armstrong's second decisive test, and he came back with new knowledge of the Helpers and Opponents. The story had to be different from the Bilbao story:

> *I think it is the first time for Guggenheim New York that the partner was different. Finland is a different [partner]. The high-skilled society, the high-educated population—it's not the same.* (Interview Data)

The revised proposal undoubtedly marked a turning point in the internationalization process of the Foundation as Guggenheim was willing to significantly negotiate the actual terms of market entry.

In order to come back and conquer, the Sender—the Guggenheim Foundation—had re-engaged, disengaged, and reframed their strategy. A significant part of the re-engagement strategy was to highlight transparency, public discussion and deliberation in and around Guggenheim Helsinki; this was to turn the Opponents into Helpers. To further this aim, the Guggenheim local team initiated a series of open "Guggenheim Helsinki Live" discussions to ensure that different voices were heard and to counter the elitist, small-circle image of the previous phase. The public events also strived to reduce the distance between the Guggenheim leadership and ordinary citizens. The Opponents were still not satisfied, and they claimed that "*everything [all important decisions] is prepared in silence…*" (Interviewee, politician). Yet, this re-engagement turned many of the previous Opponents into Helpers.

In the spring 2014, the Guggenheim Helsinki Supporting Foundation was established. Its board members included notable local business and industry leaders as well as representatives from the Guggenheim Foundation and Bilbao Museum. The Supporting Foundation was created as an independent foundation, which had the mandate to negotiate the terms with the City of Helsinki and the government. Thus, the re-engagement was much about building broad cross-sector networks across the echelons of the local society—from political decision-makers to individual artists and citizens (see Fig 8.4). This strategy of cross-societal engagement shifted the narrative toward success, as many Opponents turned into Helpers and Mr Armstrong came closer to conquering the decisive test. This change in the plot was very different from the first attempted entry where the mayor was the key contact point and sponsor of the local Guggenheim museum.

During this second entry, the Guggenheim HQ managers tried to proactively influence the general local understandings of Guggenheim as an actor. Here, the Guggenheim Foundation's narrative attempted to distance Guggenheim from what they considered damaging beliefs such as that the Guggenheim Foundation was a wealthy corporation. Armstrong's leadership actively tried to get rid of the reputational baggage that they had inherited from Krens' era. Simultaneously, the Foundation's representatives were re-engaging with those aspects of the Guggenheim legacy that were likely to resonate well with the more skeptical voices around the Guggenheim Helsinki project. This involved highlighting art as a medium to positively affect social change. In other words, the *re-engaging* and *disengaging narrative* was an attempt to change—not only the Opponents and Helpers, but also the Sender and the Object, and to

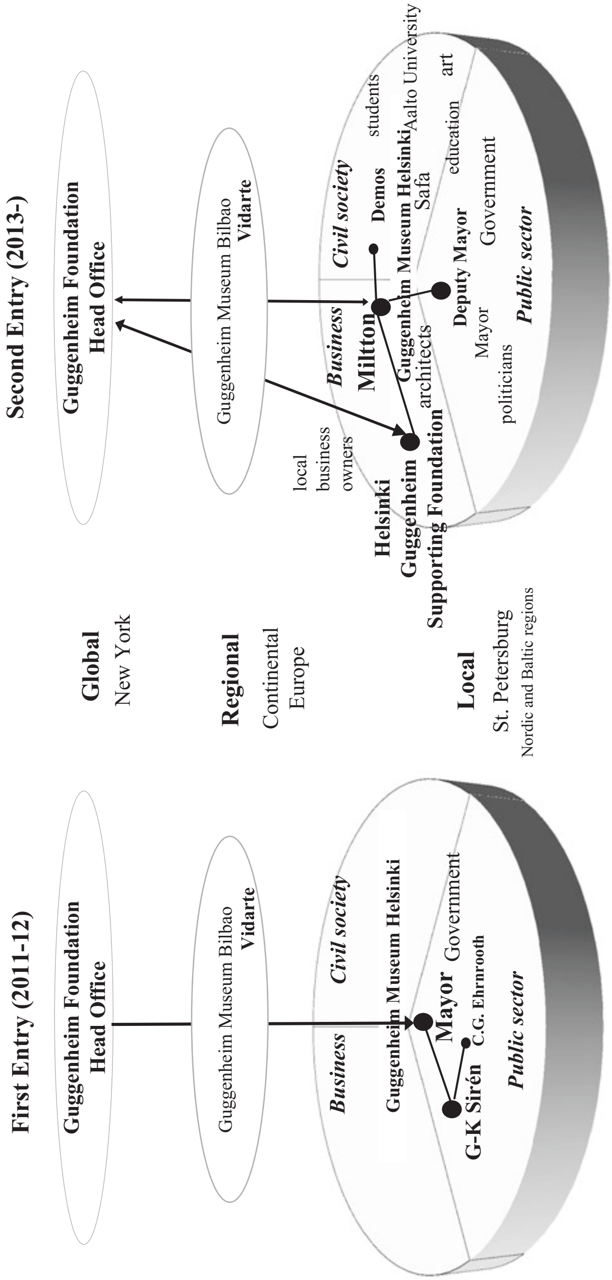

Fig. 8.4 Key actors in phase I versus phase II

influence the storied identity (Goffman 1959) of the Foundation. Where the Object in the first phase had been "an American museum franchise", it became articulated as "a non-profit institution organized for philanthropic purposes". Moreover, the Guggenheim Foundation has narrated that it is a Helper—contributing to the development of the local art field, for example, through education, and promoting Finnish art and artists through its networks. The Guggenheim Helsinki is still a story in the making with an open outcome as the final political decisions on building the museum are not yet made.

Discussion and Conclusion

Our objective in this chapter was to understand the international market entry of Guggenheim as a negotiated process of internationalization between head office managers and local actors. Using narrative theories inspired by Greimas' actantial model, we explored how the different narratives of Guggenheim's expansion took shape in the interactions between Helpers and Opponents, as well as between the re-formulations of the museum's core purpose of existence. We found that in their first attempt to enter Helsinki, Guggenheim faced increasingly powerful Opponents and fewer Helpers than they expected based on the success-narrative of market entry to Bilbao. The Guggenheim Foundation relied on few local actors and seemed weakly embedded in the local networks—they did not understand the institutional complexity of division of political power and decision-making authority (Greenwood et al. 2011; Saka-Helmhout et al. 2016). The narrative of the local Opponents could be framed as *external threat*. The lesson Guggenheim learned after the failed first entry was that they needed to devote attention to all parts of the narrative through *re-engaging, disengaging, and reframing*. Each actant in the narrative—the Object itself (what the Guggenheim museum stands for), the Receiver (who benefits), the Helpers (funders, media, and politicians), and the Opponents (funders, media, and politicians)—had to change.

In the second entry, when Mr Armstrong and his allies (Subject) came back, they had worked on all parts of the frame: The narrative of the Guggenheim museum was reframed into a philanthropic institution (Object), new calculations were made on the financial and societal benefits of the museum (Receiver), a local fundraising organization was established (Helpers), and more key individuals and opinion leaders were brought on board through widespread cross-societal engagement (turn Opponents into Helpers). Mr Armstrong also got engaged in the local public debate (Subject). In this way, the Guggenheim Foundation was able to transform the entire narrative and eventually conquer the second test before success—the decisive test. According to Haley and Boje (2014), internationalization is characterized by disruptions in planning and complex cultural identity negotiations across countries. Our study shows that assumptions and experiences of the various participants, accentuated by the hegemonic success narratives (think of "the Bilbao Effect"), can empower certain actor positions and give rise to counter-narratives. The story is still in the making; it remains to be seen whether the Subject, Mr Armstrong and his allies, will be able to accomplish the glorifying test by building a museum in Helsinki as well.

Our study also shows that during the Krens' era, Guggenheim "experimented" with multiple international market entries that were short and fast and did not involve high commitment from the leadership team. The pace and speed of internationalization were an outcome of the efforts of the Foundation leaders as well as the political negotiations in each target country (see also Casillas and Acedo 2013). Our findings reinforce the irregular and non-linear nature of the internationalization process. They suggest that past international market entries and international heritage (Welch and Welch 2009) of the organization may have a negative impact on its legitimacy during subsequent international moves and related negotiations. Vermeulen and Barkema (2002, p. 650) emphasize that "there are limits to how much expansion an organization can cope with" and digest at once. They maintain that an expansion pattern characterized by too high a speed, wide dispersal into different countries, and irregularity of the process is detrimental for the organization.

Finally, our analysis suggests that non-profits may, in fact, be surprisingly similar in their internationalization as MNEs. However, in the socially constructed storyline (Hurmerinta et al. in press) of the art non-profit's internationalization process presented here, considerable weight is placed on non-business actors such as city politicians. We welcome future research that extends and deepens how network embeddedness and local negotiations influence the internationalization of contemporary non-profits. Thus, we join Doh and Lucea (2013) in advocating non-profits as highly relevant research objects for the IB community.

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9

The Internationalization of Socially Oriented Organizations

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Introduction

The world economy has experienced solid growth in the last quarter century, but this growth has evidently not eradicated poverty and income inequality (Ahlstrom 2010; Alvarez et al. 2015). A large portion of the world's population, between two and four billion people, lives on the equivalent of less than two US dollars per day (World Bank 2012). Income inequality even increased in most Organisation for Economic Co-operation and Development countries in the new millennium (OECD 2011), and neither the government nor the market can fully resolve social pains, such as global poverty, endemic disease, homelessness, famine and pollution. Socially oriented organizations, such as nonprofit organizations (Stiglitz 2006; Boli and Thomas 1997) and social ventures (Zahra et al. 2008, 2014), have, thus, increasingly stepped in to fill the gap between the public sector and the private sector and address the pervasive social pains (Teegen et al. 2004).

The above-noted socially oriented organizations and social ventures are known to be capable of tackling social problems and making an impact at the global level. International business scholars have nevertheless long ignored the phenomenon of the internationalization of socially oriented organizations. The classic research realm of international business

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(IB) was limited to firms of the private sector, which were considered to be exclusively profit oriented in line with the post-war organization ontology (Teegen et al. 2004). Despite this disregard in IB, there have been studies on the internationalization of socially oriented organizations in other fields of business and management, such as nonprofit management and nonprofit marketing. However, most of those studies focused on how socially oriented organizations, especially nonprofit organizations, interacted with the institutional context in the home or host country and other actors embedded in the same institutional context, such as governments, firms and inter-governmental organizations (London and Hart 2004; Teegen et al. 2004; Rondinelli and London 2003). Existing theories of the internationalization of socially oriented organizations focused on explaining how socially oriented organizations behave in the global context (such as international markets) rather than why socially oriented organizations internationalized. Business scholars know little about the determinants of the internationalization of socially oriented organizations.

This chapter aims to add to the limited extant knowledge on the internationalization of socially oriented organizations by exploring the determinants or predictors of likely internationalization, using a data set of 271 socially oriented organizations from 63 countries. More specifically, we examined the extent to which the organizational form, social nature and home country institutional environment of a socially oriented organization might predict its likelihood of internationalization. After reviewing existing theories of social entrepreneurship (SE), sustainability and nonprofit management, we selected different types of social interventions typically undertaken by socially oriented organizations as explanatory variables. Subsequent analysis showed that socially oriented organizations that conduct social interventions aimed at improving beneficiaries' satisfaction with employment opportunities and employment conditions were less likely to be international than socially oriented organizations that do not. Socially oriented organizations that conduct social interventions to improve beneficiaries' satisfaction with formal and informal education, natural and communal environment, physical and mental health, or access to physical resources such as clean water, energy and housing were more likely to be international than socially oriented organizations that do not. We also found that nonprofit organizations do not differ significantly from social ventures in terms of likelihood of internationalization and that stronger and better-developed institutions in the home country provided better institutional support to the internationalization of socially oriented organizations.

Literature Review and Hypotheses Development

Two Types of Socially Oriented Organizations and Their Internationalization

The global business environment nowadays is different from that of the 1990s and earlier, when most existing theories of internationalization of ventures were introduced. The evaluation of an organization's performance has changed, as indicated by the notion of "triple bottom line" (Norman and MacDonald 2004): the public evaluates an organization's contribution to the society by not only its financial performance but also its performance in the social and environmental domains. Social and environmental damages caused by organizations, such as economic recession, unemployment, disposition to crime, civil discord, environmental pollution and waste of non-renewable resources, are considered to be social and environmental costs with negative effects.

Value creation within organizations has also changed, in line with the changes in the evaluation standard for organizational performance. Value creation within organizations has shifted to the creation of blends of economic, social (societal) and environmental values (Emerson 2003), instead of a traditional exclusive focus on the creation of economic value. Academic understandings of value creation have deepened in recent years with the development of the academic fields of SE and sustainability: the ultimate goal of social entrepreneurial activities in socially oriented organizations is to create social benefits contributing to the overall well-being of the society (Kroeger and Weber 2015). The term "social", inherited from the concept of social benefits (Gonzalez et al. 2002), was used in the field of SE and non-profit management to generalize for value other than economic profit for the entrepreneur (Kroeger and Weber 2015). The new broad concept of social value in the context of SE and sustainability includes not only non-economic gains to the society and community (a narrow definition of social or societal value) and the environment (environmental value) but also economic gains to individuals other than the entrepreneur (Shepherd and Patzelt 2011; Patzelt and Shepherd 2011) (Table 9.1).

According to the traditional post-war ontology of organizations, ventures in the private sector are considered to be profit oriented that often cause social and environmental damages with negative effects (Teegen et al. 2004). There is an emerging phenomenon that some ventures can actively create social and environmental wealth, which positively contributes to the overall well-being

Table 9.1 Literature review on social value and social interventions

Broad concept of social value: Value other than economic value for the entrepreneur (Patzelt and Shepherd 2011)	**Social interventions (academics)—Seven life domains** (Cummins 1996)	**Social interventions (practitioners)—Ten life domains** (Measuring national well-being by Office for National Statistics, UK, 2015)
Economic gains for individuals other than the entrepreneur	satisfaction with financial situation	Personal finance (reported financial difficulty, satisfaction with the income of their household, real median household income, median wealth per household including pension wealth, individuals in households with less than 60 percent of median income after housing costs)
		Economy (inflation rate, UK public sector net debt as a percentage of GDP, real net national disposable income per head)
		What we do (unemployment rate, satisfaction with their job)
Non-economic gains for the society and community	satisfaction with health	Health (life expectancy at birth, reported a long-term illness and a disability, satisfaction with own health condition, evidence indicating depression or anxiety)
	satisfaction with health[a]	Personal well-being (very high rating of satisfaction with their lives overall (%), very high rating of how worthwhile the things they do are (%), rated their happiness yesterday as very high (%), rated their anxiety yesterday as very low (%), population mental well-being)
	satisfaction with community integration	Our relationships (average rating of satisfaction with family life, average rating of satisfaction with social life, has a spouse, family member or friend to rely on if they have a serious problem)
	satisfaction with housing, *satisfaction with community integration*[a], satisfaction with safety	Where we live (satisfaction with own accommodation, households with good transport access to, key services or work, agreement on whether they felt they belonged to their neighbourhood, felt safe walking alone after dark, crimes against the person)

(*continued*)

Table 9.1 (continued)

	satisfaction with community integration[a], *satisfaction with health*[a], satisfaction with equality	*What we do*[a] (*unemployment rate*[a], *satisfaction with their job*[a], satisfaction with their amount of leisure time, volunteered more than once in the last 12 months, engaged with/participated in arts or cultural activity at least three times in last year, adult participation in 30 minutes of moderate intensity sport, once per week)
	satisfaction with community integration[a] *satisfaction with equality*[a]	Governance (trust in national Government, voter turnout at UK General Elections)
	satisfaction with education	Education and skills (UK residents aged 16–64 with no qualifications, five or more GCSEs A* to C including English and Math, human capital—the value of individuals' skills, knowledge and competences in labour market)
Non-economic gains for the environment	Not included	Natural environment (household waste that is recycled, energy consumed within the UK from renewable sources, protected areas in the UK, total greenhouse gas emissions) *Where we live*[a] (accessed natural environment at least once a week in the last 12 months)

[a]Repetitive items *in italic*

of the society (or the community) (Stiglitz 2010), instead of wrecking social and environmental damages with negative effects. Those ventures that focus on creating blends of economic and social values and contributing to the overall well-being of the society or community are named as social ventures (Zahra et al. 2009, 2014).

Social ventures were theoretically predicted to be able to internationalize (Zahra et al. 2008). Some entrepreneurial opportunities that aim at social change (e.g. to fill the global poverty gap) or environmental sustainability (e.g. to fight against climate change and energy depletion) are inherently of international nature and embedded in the transnational context (Zahra et al. 2008, 2014). Social ventures, in which those opportunities are pursued, would inevitably have border-crossing business activities. Although the internationalization of social ventures had been recognized and regarded as different from the internationalization of profit-oriented ventures, empirical evidence on the internationalization of social ventures is still scarce in the existing IB literature, especially before 2014 (Zahra et al. 2014; Stephan et al. 2015; Audretsch 2015; Ghauri et al. 2014; Roy and Goll 2014).

Nonprofit organizations are a different form of socially oriented organizations, which also aim at creating social value and have been long known to be capable of internationalizing their operations (Stiglitz 2006, 2010; Boli and Thomas 1997). Nonprofit organizations follow a nonprofit mechanism, which relies on inflow of external funding, such as public funds and philanthropic donations. Once the inflow of external funding ceases, the nonprofit mechanism stops working (Yunus 2007). Nowadays, nonprofit organizations also face market pressure and competition for limited resources (Alexander and Weiner 1998; Andreasen and Kotler 2003). As a consequence, they have started to adopt business-like techniques and develop income-generating activities to reimburse at least parts of their operating costs (Goerke 2003). However, the earned income is still insufficient to cover all the operating costs and sustain continuous operations (Goerke 2003). On the contrary, social ventures are economically sustainable (Dees 1998; Santos 2012). Although social ventures can still be partially funded by external donations or public funds, they rely on their own earned income to sustain operations or support expansion, either domestically or internationally.

Social ventures and nonprofit organizations share similarities, despite their core difference on economic sustainability. Both social ventures (Zahra et al. 2014) and nonprofit organizations (Gonzalez et al. 2002) are socially oriented organizations that are motivated to create social benefits contributing to the overall well-being of the society or community (Kroeger and Weber 2015). Social entrepreneurial activities can exist in a wide range of organizations

(Zahra et al. 2009), including both social ventures (Zahra et al. 2014) and nonprofit organizations (Alvarez et al. 2015). Both social ventures and nonprofit organizations with profit-generating activities create blends of economic and social values. At the same time, both social ventures (Zahra et al. 2014) and nonprofit organizations (Alvarez et al. 2015) can expand their operations internationally or even globally and alleviate social pains beyond their home country. The current business and management literature has, however, not yet compared social ventures and nonprofit organizations in terms of internationalization.

Nonprofit organizations are driven by inflow of external funding, especially inflow of public funds (Kearns 1996; Bryson 2011). The public sector that manages the public funds, such as national or regional government institutions, in most cases only has intentions or interests to invest in nonprofit organizations that aim to create social benefits within the national (or regional) border, and not those with interests beyond the national (or regional) border (Kearns 1996). Nonprofit organizations' reliance on external public funds would limit their potential to geographically expand their operations, especially beyond the national border. On the contrary, social ventures rely on their own earned income to sustain operations and expand. Decision making regarding international expansion in social ventures is subject to lesser influence by the public sector. We therefore hypothesize that:

H1: *Social ventures are more likely to internationalize than nonprofit organizations.*

Social Interventions and Internationalization

The ultimate goal of SE, no matter the form of socially oriented organization involved, is to create social value, which contributes to the well-being of disadvantaged individuals (Martin and Osberg 2007) and the overall well-being of the society (Zahra et al. 2009, 2014). Disadvantaged individuals are often referred to as beneficiaries in the social context (Bruce 1995; Gonzalez et al. 2002). However, similar to the other types of value, social value is intangible (Di Domenico et al. 2010). Scholars usually measure or categorize the output of value that is created in an organization. For example, the output of economic value for the entrepreneur, which is created in a venture, is the profit that the entrepreneur can withdraw from the venture. The output of social value is referred to as social interventions that focus on the eventual changes in well-being of the beneficiary group (Kroeger and Weber 2015).

For example, a microfinance institute in Bangladesh helped women at the bottom of the pyramid by providing microfinance and investment lessons to help them break the vicious cycle of poverty. In this case, the microfinance institute conducted microfinance interventions that improved the financial situation and investment skills of the beneficiary group (women at the bottom of the pyramid in Bangladesh), by providing the beneficiary group micro-credits and investment lessons (Yunus 2007; examples given in Kroeger and Weber 2015).

Social interventions are not as homogeneous as economic profit, which can be easily measured by monetary unit (Di Domenico et al. 2010). The realization of social value of different nature creates different types of social interventions (Kroeger and Weber 2015). Social interventions are heterogeneous (Cummins 1996) and highly context dependent (Zahra et al. 2008). Social interventions can have different beneficiary groups, even within the same community. Similar beneficiary groups in different institutional and cultural contexts can have different social demands. Social demands in one community (e.g. women's limited access to gym and other sport facilities in an Islamic community) could become nonexistent in another community within a different context (e.g. a Northern European community). It is thus challenging to categorize and measure different and unrelated interventions that serve different beneficiary groups in different institutional and cultural contexts (Austin et al. 2006; Dacin et al. 2010; Mair and Marti 2006; Zahra et al. 2009; Kroeger and Weber 2015).

In addition, scholars of SE and nonprofit management (Diener et al. 2013; Kroeger and Weber 2015) or practitioners (e.g. Office for National Statistics 2015) widely accept that the overall well-being of a community (or a society) is a function of satisfactions in multiple fictive life domains. One of the most well-known models has a design of satisfactions in seven life domains (Cummins 1996), specifically education, financial situation, health, housing, community integration, equality and safety (see Table 9.1). A socially oriented organization can conduct social interventions to improve satisfaction in one or multiple life domains. This idea of life satisfaction in multiple domains is now widely adopted by practitioners. For example, the Measuring National Well-being Project by the Office of National Statistics (2015) measures life satisfaction in ten life domains. Though not exactly similar, these ten life domains largely overlap with the seven life domains of Cummins' original model (1996). Since Cummins' theoretical model was introduced almost two decades ago, it might not perfectly fit into the present socio-economic context. Practitioners, such as the Office of National Statistics (UK), drew on academic research in the field of SE and sustainability to extend the range of life domains. For example, the development of knowledge on environmental sustainability (Shepherd and Patzelt 2011) significantly led to the inclusion of satisfaction with the natural and communal environment. Satisfaction in the health domain was extended to both physical health and mental health. Satisfaction in the education domain was extended to both formal education and work-related informal education (see Table 9.1).

Most of the existing life satisfaction theories from either academics or practitioners were developed in the context of developed economies. These existing models may be unsuitable for a developing economy context, as they largely omit some social pains that widely exist in developing economies but are less common or almost nonexistent in developed economies, such as hunger and malnutrition and gender equality in patriarchal societies (see, for example, the 17 Sustainable Development Goals by the United Nations 2014). Social interventions that alleviate those social pains can significantly increase the well-being of beneficiary groups in some developing economies. In sum, existing theories of multiple-domain life satisfaction do not share a uniform understanding of how to divide life domains, which can be further used to categorize social interventions. In addition, these theories might not fit the context of developing economies. As a result, based on a data set covering 271 socially oriented organizations in 63 counties, we employ exploratory methods to define our own categories of life domains and use them to categorize types of social interventions.

Socially oriented organizations differ according to the type of social interventions they undertake, which then affects their likelihood of internationalization, as different types of social interventions tend to have different resource requirements. The delivery of some social interventions relies heavily on financial resources or knowledge-intensive intangible resources or tacit knowledge of the local socio-economic context and networks (Zahra et al. 2009). When a social entrepreneur tries to copy successful experience from one location to another unknown location, mobilizing and transferring financial or knowledge-based resources to the new location tends to be less challenging than obtaining relevant tacit knowledge and localized human resources. For example, undertaking social interventions in the health domain (in Table 9.1) to eradicate an epidemic in a developing economy may heavily rely on knowledge-intensive resources (e.g. low-cost medicine or medical treatment) that can only be found in a developed economy. A socially oriented organization that conducts this kind of social intervention in a developing economy is highly likely to have border-crossing activities, given the need to leverage knowledge-intensive resources located in a developed economy to meet identified needs in a developing economy. On the contrary, undertaking social interventions in the safety domain (in Table 9.1), to make females feel safer to walk alone after dark in a British community, would require deep understanding of the social, economic, demographic and historical reasons behind this type of crime, in addition to relationship building with the local police, other public actors, residents in the community or even potential female attackers. A socially oriented organization that conducts social interventions to make females feel safer to walk alone after dark is more likely to stay within that community than expand internationally, since the organization cannot easily mobilize and transfer the required resources (such as localized human resources and embeddedness in the local networks) from one community (or society) to another. Therefore, we hypothesize that:

H2: *Socially oriented organizations that conduct different types of social interventions differ on the likelihood of internationalization.*

Institutional Strength in the Home Country and Internationalization

Institutions refer to authoritative guidelines and constraints for individual behaviours, which are deeply embedded in the social structure (North 1990; Scott 2005). Institutional environments have strong impacts on cross-border entrepreneurship activities by shaping the entrepreneur's cognition (Zahra et al. 2005). Strong institutions are characterized by good enforcement of commercial and intellectual property laws, transparent judicial and litigation systems, developed factor markets and efficient market intermediates (Peng 2003). Better-developed institutional environments in the home country are found to support the internationalization of firms (Wu and Chen 2014), since strong institutions can provide more tangible and intangible resource support (Buckley et al. 2007; Stephan et al. 2015). By contrast, unstable and frequently changing institutional environments of the home country cannot provide sufficient institutional support for the internationalization of socially oriented organization and sometimes even prohibit internationalization (Wu and Chen 2014). Therefore, we hypothesize that:

H3: *Socially oriented organizations from economies with stronger institutions are more likely to internationalize.*

Methods

Data

The data used in this study were adopted from the Social Entrepreneur Database by the Schwab Foundation for Social Entrepreneurship. The Social Entrepreneur Database by the Schwab Foundation included a diverse range of real-life social entrepreneurs who created socially oriented organizations tackling different forms of social issues in countries with different development levels. The Database included 271 real-life socially oriented organizations from 63 countries (listed in Table 9.2) and provided us with an overview of the spectrum of SE activities, which was often overlooked in country-specific case studies. The Database provided detailed descriptions of the social issues tackled by each socially oriented organization, and the socially significant products, services or solutions that the organization provides. The Database also outlined the educational and experiential background of the entrepreneur for each case.

The Database and other supplementary textual documents were first coded into quantitative data used in a sequential statistical analysis in early 2015. The quantitative data reflected each socially oriented organization's status (e.g. cross-border activities, social interventions undertaken etc.) by the end of the year 2014.

Dependent Variable

The dependent variable "Internationalization" measured whether the socially oriented organization had activities beyond its national border or not. If a socially oriented organization had activities beyond its national border, it was considered to be "international"; if a socially oriented organization did not

Table 9.2 List of home countries of socially oriented organizations on the data set

Home country (*N* = 63)	Argentina, Australia, Bangladesh, Belgium, Bolivia, Bosnia and Herzegovina, Brazil, Cambodia, Cameroon, Canada, Chile, China, Colombia, Czech Republic, Denmark, Ecuador, Egypt, El Salvador, France, Germany, Ghana, Guatemala, Haiti, Hong Kong, Hungary, India, Indonesia, Israel, Italy, Japan, Jordan, Kenya, Korea (Rep.), Kuwait, Laos, Lebanon, Mexico, Morocco, Myanmar, Nepal, Netherlands, Nicaragua, Nigeria, Pakistan, Paraguay, Peru, Philippines, Poland, Singapore, South Africa, Spain, Sri Lanka, Switzerland, Tanzania, Thailand, Tunisia, Turkey, Uganda, UK, Ukraine, USA, Venezuela and West Bank and Gaza

have activities beyond its national border, it was considered to be "domestic". The dependent variable "Internationalization" was a binary variable with the value of 1 if the socially oriented organization was international and the value of 0 if the socially oriented organization was domestic.

Independent Variables

Organizational Form: Social Ventures Versus Nonprofit Organizations

Social entrepreneurial activities can exist in a wide range of organizations (Zahra et al. 2009), from profit-oriented ventures with social value created as a byproduct, to socially oriented organizations with active social value creation, such as social ventures and nonprofit organizations. The Social Entrepreneur Database by the Schwab Foundation only included socially oriented organizations. Consistent with the literature (Yunus 2007; Santos 2012), the Database used organizations' economical sustainability (i.e. whether the organization's earned income can cover its operating costs or not) as the standard to differentiate social ventures from nonprofit organizations with income-generating activities. A binary independent variable "Organizational form" was created to differentiate whether a socially oriented organization was a social venture or a nonprofit organization, with the value of 1 if the socially oriented organization was a social venture and the value of 0 if the socially oriented organization was a nonprofit organization.

Types of Social Interventions

An exploratory method was used to figure out the possible types of social interventions that can be conducted by socially oriented organizations, since existing typologies do not fit the present global business environment, nor the context of developing economies. We collected textual descriptions of each socially oriented organization's targeted social issues and business models from the Social Entrepreneur Database and the official websites of the focal socially oriented organizations (terms such as vision, mission and activities were looked for) and used these as empirical data. Keywords, describing social issues of concern or socially significant products, services and innovations introduced, as well as who the beneficiaries were and how they benefited, were extracted from the empirical data (see the Appendix for examples of keywords). We focused on the eventual improvements of the well-being of beneficiaries that had been served by socially oriented organizations instead of these organizations' long-term social goals. One or multiple keywords could be extracted from each socially oriented organization, and these were then grouped into categories by their inherent similarity (Gioia et al. 1994, 2013), regardless the source of extraction. As a result, eight types of social interventions were found to be conducted by socially oriented organizations from the empirical data (Table 9.3). These were named as Codes #1.

Sequentially, we coded the empirical data for all the 271 socially oriented organizations, not by extracting keywords, but by assigning one or multiple standardized types of social interventions (as in Table 9.3) for each socially oriented organization. The coding process was conducted twice, following different alphabetic orders. The codes obtained from the sequential two coding processes were named Codes #2 and Codes #3, respectively.

Codes #1, #2 and #3 were further compared. Codes #1 and #2 shared a similarity of 87 percent. Codes #2 and #3 shared a similarity of 97 percent.

Table 9.3 Eight types of social interventions

Codes	Descriptions	Frequency	Marginal percentage
DIS	To assist disadvantaged people, such as people with disabilities, disadvantaged ethnic or religious groups and women and children on patriarchal cultures	$N(\text{DIS} = 1) = 75$	27.7%
EMP	To provide employment and growth opportunities and to improve employment conditions	$N(\text{EMP} = 1) = 55$	20.3%
EDU	To provide education, from formal education to work-related informal education	$N(\text{EDU} = 1) = 74$	27.3%
ENV	To preserve global and communal environment	$N(\text{ENV} = 1) = 53$	19.6%
HEA	To solve physical and mental health issues	$N(\text{HEA} = 1) = 75$	27.7%
HMN	To maintain equality, harmony and community integration and to reduce crimes in the community (or society)	$N(\text{HMN} = 1) = 49$	18.1%
POV	To fight against regional poverty and to support regional development, to provide microfinance to break the vicious cycle of poverty and to eradicate global poverty gap	$N(\text{POV} = 1) = 58$	21.4%
RES	To provide physical resources (e.g. electricity, fuel, clean water, housing, etc.) to people who previously had no access	$N(\text{RES} = 1) = 33$	12.2%
Total		$N = 271$	

Codes which were found to differ across Codes #1, #2 and #3 were selected and further validated by rechecking the empirical data and, if necessary, collecting additional textual data, such as corporate webpages and media exposures. One of the major sources for the differences among Codes #1, #2 and #3 was that we did not clearly differentiate between social interventions which had been conducted and long-term social missions which were targets to achieve in the future when we obtained Codes #1. The final codes were generated after validation, used in the sequential analyses and labeled as Codes #4. Codes #4 shared similarities of 83 percent, 98 percent and 97 percent with Codes #1, #2 and #3, respectively.

Eight binary independent variables “DIS”, “EMP”, “EDU”, “ENV”, “HEA”, “HMN”, “POV” and “RES” (Table 9.3) were generated to indicate whether a socially oriented organization conducted each of the eight types of social interventions or not, respectively. Each binary variable has the value of 1 when the socially oriented organization has conducted this type of social intervention and the value of 0 when it has not.

Institutional Strength in the Home Country

We measured institutional strength in the home country from the perspectives of economic development, social development and institutional development (governance) and merged a variety of data sets with multiple national-level measures. The measure for economic development was the Gross National Income (GNI) per capita adjusted in US dollars in 2014, collected from the World Bank database. The measure for social development was the Human Development Index (HDI) in 2014, collected from the United Nations Development Programme database. HDI measures the average achievements in a national economy on three basic dimensions of human development: a long and healthy life, access to knowledge and a decent standard of living. The level of governance or institutional development was measured using the Worldwide Governance Indicators (WGI) developed by the World Bank Group. Three relevant dimensions out of the total six WGI dimensions were selected and the scores on the year 2014 were used. The three measures were government effectiveness (GE), regulatory quality (RQ) and the rule of law (RL). GE measures the quality of public services, civil services and policy formulation and implementation. RQ measures the ability of the government to formulate and implement sound policies to permit and promote private sector development. RL measures the quality of contract enforcement, property rights, the police and the courts, as well as the likelihood of crime and violence. In sum, we use five continuous variables, "GNI", "HDI", "GE (WGI)", "RQ (WGI)" and "RL (WGI)" to measure institutional strength in the home country.

Control Variables

The gender of the entrepreneur and the organization's age are commonly used demographic control variables in a cross-country study of entrepreneurship (Lloyd-Reason and Mughan 2002; Van Stel et al. 2007; Estrin et al. 2013). A binary control variable, "Gender of entrepreneur", was created, with the value of 1 when the entrepreneur(s) are all male entrepreneurs and the value of 0 when the entrepreneur is female, or at least one of the entrepreneurs is female. A continuous control variable, "Organization age", was created to measure the number of calendar years from the establishment of the socially oriented organization till the end of the year 2014. For example, a socially oriented organization established in the year 2013 has an organization age of 2 years on the data set.

Models

A binary logistic regression model was ideal for this study, since the dependent variable is binary and it was intended to test the effects of two control variables in the same model. The dependent variable "Internationalization" was binary with the value of 1 if the socially oriented organization is international and 0 if the socially oriented organization is domestic. The independent variable "Organizational form" was binary with the value of 1 if the socially oriented organization is a social venture and 0 if the socially oriented organization is a nonprofit organization. Eight independent variables "DIS", "EMP", "EDU", "ENV", "HEA", "HMN", "POV" and "RES" were binary, with each representing whether the socially oriented organization conducted each of the eight types of social interventions or not, respectively. Five continuous variables, "GNI", "HDI", "GE (WGI)", "RQ (WGI)" and "RL (WGI)", were selected to measure the institutional strength in the home country from the perspectives of economic, social and institutional development. The binary variable "Gender of entrepreneur" and continuous variable "Organization age" were selected as control variables. Descriptive statistics of variables on the binary logistic regression model are summarized in Table 9.4.

Table 9.4 Descriptive statistics of variables[a]

Variables	Value[b]	Marginal percentage[c]
Dependent variable		
Internationalization	*N*(international) = 119	56.1%
	N(domestic) = 152	43.9%
Independent variables		
Organizational form	*N*(social ventures) = 84	31.0%
	N(nonprofit organizations) = 187	69.0%
Institutional strength		
GNI: Gross National Income per capital adjusted in US dollars, year 2014	24,975 (19,493)	
HDI: Human Development Index, year 2014	0.766 (0.134)	
GE(WGI): Worldwide Governance Indicators: government effectiveness, year 2014	0.479 (0.938)	
RQ(WGI): Worldwide Governance Indicators: regulatory quality, year 2014	0.464 (0.907)	
RL(WGI): Worldwide Governance Indicators: the rule of law, year 2014	0.460 (1.025)	
Principal component score of five country-level measures	0.264 (0.980)	
Control variables		
Gender of entrepreneur	*N*(including at least one female) = 84	29.9%
	N(all male) = 190	70.1%
Organization age	18.82 (11.11)	
Total	*N*(total) = 271	100%

[a]Descriptive statistics of variables "DIS", "EMP", "EDU", "ENV", "HEA", "HMN", "POV", "RES" have been included in Table 9.3 respectively and therefore excluded in Table 9.4
[b]Means and standard deviations (in parentheses) for continuous variables
[c]Marginal percentages for categorical variables

Results

Institutional Strength in the Home Country

The five national-level measures strongly correlate with each other (Pearson correlation coefficients range from 0.797 to 0.957, as in Table 9.5), thus

Table 9.5 Correlation matrix of five country-level measures of strength of national institutions

		GNI	HDI	GE(WGI)	RQ(WGI)	RL(WGI)
Correlation	GNI	1	0.837***	0.833***	0.800***	0.828***
	HDI	0.837***	1	0.863***	0.797***	0.806***
	GE(WGI)	0.833***	0.863***	1	0.934***	0.957***
	RQ(WGI)	0.800***	0.797***	0.934***	1	0.946***
	RL(WGI)	0.828***	0.806***	0.957***	0.946***	1

***$p < 0.001$

implying problems with multicollinearity. A principal component score of the five national-level measures was then used instead of the five national-level measures. A single component emerged from the principal component analysis of the five national-level measures, with an eigenvalue of 4.44, explaining 88.9 percent of the variance. The component loadings were all in excess of 0.910.

Results of Binary Logistic Regression

The results of the binary logistic regression are reported in Table 9.6. The model's chi-square significance was smaller than 0.001, showing that the model was a significant fit of the data. The gender of the entrepreneur and the age of socially oriented organization were not critical in predicting the likelihood of internationalization of a socially oriented organization.

We found that social ventures did not differ significantly from nonprofit organizations in terms of the likelihood of internationalization. **H1** was therefore refuted. We found that socially oriented organizations conducting EMP-type social interventions were less likely to be international than those not conducting EMP-type social interventions. We also found that socially oriented organizations conducting EDU-, ENV-, HEA- and RES-type social interventions were more likely to internationalize than those not conducting EDU-, ENV-, HEA- and RES-type social interventions, respectively. **H2** was supported. We found that socially oriented organizations from economies with stronger institutions were more likely to internationalize. **H3** was also supported.

Table 9.6 Results of binary logistic regression

International[§]	*B*
Independent variables	
Organizational form	
social ventures[a]	0.311(0.316)
Type of social interventions	
DIS[b]	0.082 (0.349)
EMP[b]	−0.772*(0.375)
EDU[b]	0.965**(0.347)
ENV[b]	1.133**(0.386)
HEA[b]	1.049** (0.360)
HMN[b]	0.092 (0.393)
POV[b]	0.453 (0.368)
RES[b]	0.903* (0.455)
Institutional strength (home country)	
Principal component score of five country-level measures	0.739***(0.151)
Control variables	
Gender of entrepreneur	
Including at least one female entrepreneur[c]	−0.391(0.314)
Organization Age	0.008(0.012)
Model fit	
N	271
Deviance (−2 log likelihood)	323.490
χ^2	48.167***
df	12
Nagelkerke pseudo R^2	0.218

$^{*}p < 0.05$, $^{**}p < 0.01$, $^{***}p < 0.001$
[§]The reference group is to be domestic
[a]The category of nonprofit organizations with profit-making activities is set to zero because it is redundant
[b]The categories of not creating one of the eight types of social interventions (DIS, EMP, EDU, ENV, HEA, HMN, POV or RES) are set to zero respectively because they are redundant
[c]The category of all male entrepreneurs is set to zero because it is redundantStandard errors in parentheses

Discussion

The Organizational Form of a Socially Oriented Organization Is Not Critical in Predicting Its Likelihood of Internationalization

We found that social ventures did not differ significantly from nonprofit organizations in terms of the likelihood of internationalization. This suggests that whether a socially oriented organization is economically sustainable (or not) is not critical on its decision to internationalize or not. Socially oriented organization's internationalization decision might depend more on other factors, for example, where the targeted beneficiaries are located and whether the resources required to undertake social interventions to improve the well-being of the targeted beneficiaries are located within the same national border. If some of the required resources are located in a different country from that of the targeted beneficiaries, the delivery of social interventions would inevitably involve cross-border resource combination. Socially oriented organizations internationalize when conducting social interventions that require cross-border resource combination. However, this finding cannot be fully verified in this study and needs to be tested in future research.

Although social ventures and nonprofit organizations do not differ significantly on the likelihood of internationalization, international social ventures and international nonprofit organizations might still differ on market choice. Social ventures are expected to have similar international market selection strategies as profit-oriented ventures, since the total amount of resources for economically sustainable social ventures is limited. By contrast, nonprofit organizations can leverage the advantages of external funding inflow and choose to expand into international markets with deeper social pains. Those international markets might be less attractive to social ventures since operations in those markets are less likely to be delivered in an economically sustainable manner due to pervasive institutional failure and weak institutional support. The market choice of international social ventures and that of international nonprofit organizations still need to be further evaluated in future research.

Types of Social Interventions Conducted by Socially Oriented Organization and Likelihood of Internationalization

We found that socially oriented organizations that conducted EMP-type social interventions were less likely to internationalize than those which did not. The reason could be that conducting social interventions that improve beneficiaries' satisfaction with employment opportunities and employment condition relies heavily on the social entrepreneur's knowledge of the local socio-economic context and embeddedness in the local networks (Zahra et al. 2009). Socially oriented organizations that successfully conducted EMP-type social interventions found it difficult to rapidly copy their successful experience from one community (or country) to another community (or country). The reason could be that it is time consuming and costly to gather the required tacit knowledge and localized human resources in the new community (or country).

We also found that socially oriented organizations that conducted EDU-, ENV-, HEA- or RES-type social interventions were more likely to internationalize than those which did not. The reason could be that socially oriented organizations could leverage the advantages of knowledge-intensive intangible resources or capabilities and innovation (Cavusgil and Knight 2015) to improve beneficiaries' satisfaction with formal and informal education, natural and communal environment, physical and mental health, and access to physical resources such as clean water, energy and housing. For example, socially oriented organizations can introduce low-cost and technologically innovative intraocular lens and cataract surgeries to cure blind people in poor communities; they can also introduce low-cost and technologically innovative UV-light devices to clean contaminated water in natural water resources to provide people in poor communities with access to clean and safe water sources and eradicate water-borne epidemics. In addition to technological innovation, socially oriented organizations can leverage the advantages of socially significant and innovative services or solutions to improve beneficiaries' satisfaction with education, environment, health and access to physical resources. For example, socially oriented organizations can introduce innovative education methods to help children who are away from, or cannot survive, in the national formal education system. In sum, socially oriented organizations that conduct EDU-, ENV-, HEA- or RES-type social interventions can leverage the advantages of knowledge-intensive resources and technological or social innovation to achieve internationalization.

Lastly, we found that socially oriented organizations which conducted DIS-, HMN- or POV-type social interventions did not differ in terms of the likelihood of internationalization from those which did not. In most cases, conducting social interventions that help disadvantaged beneficiary groups, improve community integration and harmony, or eradicate poverty heavily relied on the social entrepreneur's knowledge of the local socio-economic context and embeddedness in the local networks (Zahra et al. 2009), similar to conducting EMP-type social interventions. For example, socially oriented organizations that conduct social interventions to reduce the reliance of local businesses on the mafia and increase community harmony in Southern Italy required deep understanding of social, cultural, economic and historical backgrounds of the Mafia and Mafia-influenced community and trust-building with the local business owners to help them fight against the fear of the Mafia. The successful experience of those socially oriented organizations cannot easily be copied beyond the Mafia-influenced communities in Southern Italy. However, at the same time, socially oriented organizations that conduct social interventions to help disadvantaged beneficiary groups, improve community integration and harmony or eradicate poverty can destroy the dated social systems and introduce revolutionary changes, by instigating new and more suitable social systems (see examples of Social Engineers in Zahra et al. 2009), and that experience can be used beyond national borders. For example, microfinance institutes can conduct microfinance interventions to break the vicious cycle of poverty by changing the social structure and copying successful experience nationwide or beyond the national border, internationally or even globally. Socially oriented organizations which conduct DIS-, HMN- or POV-type social interventions have a diverse range of impact, from community-based to global.

Home Country Institutions of Socially Oriented Organization and Likelihood of Internationalization

The institutional contexts of both the home country and the host country are long known to have a strong impact on the internationalization of profit-oriented ventures (Buckley et al. 2007; Wu and Chen 2014). We discovered that stronger and better-developed institutions in the home country provided better institutional support not only to the internationalization of profit-oriented ventures, but also to socially oriented organizations. That said, the impact of the institutional environment in the home country on the internationalization of socially oriented organizations and profit-oriented ventures still needs to be further investigated in the future.

Conclusion

Based on a data set covering 271 socially oriented organizations from 63 countries with rich textual details, we explored the impact of three potential determinants of the internationalization of socially oriented organizations. The three potential determinants are (1) the organizational form, whether the socially oriented organization is economically sustainable or not; (2) the social nature, which types of social interventions the socially oriented organization undertakes and (3) the strength of the institutional environment in the home country.

Our findings are as follows. The organizational form of a socially oriented organization (i.e. a social venture or a nonprofit organization) is not critical in determining its likelihood of internationalization. The conduct of social interventions to improve beneficiaries' satisfaction with employment opportunities and employment condition by a socially oriented organization reduces its likelihood of internationalization. The conduct of social interventions to improve beneficiaries' satisfaction with formal and informal education, natural and communal environment, physical and mental health, and access to physical resources such as clean water, energy and housing by a socially oriented organization increases its likelihood of internationalization. Stronger and better-developed institutions in the home country can provide better institutional support for the internationalization of socially oriented organizations.

The findings help reveal the nature of the internationalization of socially oriented organizations. Socially oriented organizations internationalize when conducting social interventions whose delivery requires cross-border resource combination. In most cases, the requirement for cross-border resource combination arises because the targeted beneficiaries and at least some of the necessary resources for social interventions were not located in the same country. The findings also have implications for policy makers and public money managers. Socially oriented organizations differ in their capability for international expansion: some only stay in a local community, while others can diversify operations and have an impact at the global level. Socially oriented organizations of different organizational forms and social nature require different resources (both tangible and intangible) and support from public institutions for their continuing operations and expansion.

Appendix: Examples of Keywords Extracted Corresponding to the Eight Types of Social Interventions

Codes	Examples of keywords
DIS	disadvantaged, vulnerable, marginalized, neglected group, grassroots, (people) excluded from society, to obtain status in society, (people with) physical/mental disabilities, physical disabled/handicapped/blind/visually impaired/deaf/hearing impaired (people), women and children (after decades of wars/long-term absence of male family members/etc.), rural women/youth, refugees, slum dwellers, migrants labourers
EMP	*Keywords linked with employment opportunities:* employment/job opportunities, job placements, jobless, unemployed, excluded from opportunities, devoid of opportunities *Keywords linked with employment conditions:* labour conditions, employment conditions, protection from malpractices/hazards
EDU	*Keywords linked with formal education:* (unable to) read and write, (il)literacy, access to education, (high) dropout rate, (low) enrollment rate, education/enrollment of girls, improve school enrollment/retention/(public) school performance/outcomes/passing rates, (lack of) school facilities, access to books/libraries, access to student loans, teaching methodology, (to improve) reading/writing/mathematics capabilities, (to promote) problem solving/critical thinking, alternative path (for high school/college education) *Keywords linked with informal education:* professional training, vocational training, skills training, market-relevant skills, capacity building, agricultural education, to build/develop (self-) confidence
ENV	(environmentally/ecologically) sustainable, sustainability, ecotourism, conservation, to safeguard rainforest, to combat the trafficking of wildlife, to conserve species/ecosystems, biodiversity, to reverse depleted fish stocks/sustainable fishing, climate change, low carbon communities, to reduce energy use/emissions, low environmental impact, (ecologically) sustainable farming/agriculture, (to reduce) use of inorganic fertilizers/pesticides/herbicides, micro-irrigation technology (to save water use), pollution monitoring, consumer awareness/conscious consumption, urban/communal environmental issues, green spaces, recycling, waste management, hazardous waste, bio-degradable plastics
HEA	*Keywords linked with physical health:* healthcare, to improve healthcare access, health services, health needs, health risks (associated with…), post-care support, (high) infant mortality rate, low-cost infant warmer, sanitary conditions, public health, epidemics, (to eradicate) cholera/typhoid/malaria/tuberculosis, HIV treatment/care support, (low-cost) cataract surgery/intraocular lenses/ophthalmic products, blood cancer, malnutrition, chronic hunger, (affordable/specialized) diabetes care, low-price food, food scarcity, food security *Keywords linked with mental health:* mental/psychological health/illnesses/diseases, anxiety, depression

(*continued*)

Appendix (continued)

Codes	Examples of keywords
HMN	(gender/race/income/social class (caste)) (in)equality, empowerment of women, women's leadership, human rights, (post-communism) political transformation, civic engagement, to build a democratic state, social change, crime prevention, crime victims, Mafia extortion, (to prevent) domestic violence/abuse, to promote cultural integrity, restoration and enhancement of heritage sites, handicraft/craft production, community/society harmony, social integration, social inclusion, community participation/collaboration, neighborhood transformation
POV	poverty, to eradicate poverty, to remove the structural causes of poverty, impoverished region, income generating, wealth creation, economic development, regional/rural development, limited financial resources/funding, microfinance, microcredit, micro-loans, micro-leasing arrangements
RES	safe/unsafe/clean (drinking) water, (water) purification, (affordable) water filters, solar energy/lighting/lantern/mobile phone charger, biomass-based electricity, inexpensive fuel (biogas), mini power stations (fueled by weeds and agricultural wastes), micro-hydro plants, cost-effective electricity distribution system, (affordable/cost-effective) housing, homelessness, post-earthquake reconstruction, (to recycle and distribute) clothing/bicycles/under-utilized resources (from urban households to the rural poor, or from Europe to sub-Saharan Africa), to develop distribution network (of consumer goods to reach rural villages)

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10

International Knowledge Flows, Productivity and Growth: Evidence from MNEs in the UK

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Introduction

As observed by Krugman (1992, p. 9), "productivity isn't everything, but in the long run it is almost everything. A country's ability to improve its standard of living over time depends almost entirely on its ability to raise its output per worker. World War II veterans came home to an economy that doubled its productivity over the next 25 years; as a result, they found themselves achieving living standards their parents had never imagined. Vietnam veterans came home to an economy that raised its productivity less than 10 percent in 15 years; as a result, they found themselves living no better—and in many cases worse—than their parents."

Until recently, however, neoclassical theory considered capital accumulation as a main source of economic growth, while technological progress has been treated as an exogenous process determined by a time trend. Only relatively recent studies by Romer (1990) and Grossman and Helpman (1991) have explored the importance of commercially oriented research and development (henceforth R&D) expenditures as a main factor driving technological change and productivity growth. The main idea of these studies is that new inventions streaming from R&D expenditures add to the cumulative stock of knowledge, which in turn affects national productivity levels. Griliches

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(1988) and Coe and Moghaddam (1993) have also provided sound empirical evidence that cumulative domestic R&D is an important factor determining productivity and ultimately growth in real GDP and real GDP per capita.

The importance of innovation for long-run growth is now well established both in the academic literature and in policy circles (Veugelers and Cassiman 2004). There has been a long-standing literature that has identified multinational enterprises (MNEs) as being important actors who transfer technology across international borders (Dunning and Lundan 2008). Initially, the emphasis in the literature was on the role of foreign direct investment (FDI) as a means whereby firms with an advantage in technology could exploit that advantage in overseas markets. It is also recognized that firms might also exploit such advantages through either licensing of the technology or exporting.

The literature on innovation has explored in depth the fact that innovation is highly concentrated geographically (Feldman 1999). The literature on clusters has largely emphasized very localized processes which promote innovation. These include the exchange of tacit knowledge, the importance of specialised suppliers of inputs, which encompasses universities and research institutes, and the mobility of highly skilled labour between firms. More recently, this literature has come to place increasing emphasis on the importance of *external* linkages for cluster dynamism. These linkages may operate at a range of spatial scales up to the global scale (Binz et al. 2014; Herstad et al. 2014). Such linkages may bring technological know-how, highly skilled labour and money, all of which may contribute to innovation inputs and outputs in particular locations. A rather extensive body of literature has examined how innovation and technical change are affected by international transmission of knowledge by examining different channels such as FDI, trade, licensing, cross-patenting activities, input–output relations, strategic alliances, international networks and international R&D collaboration. MNEs have been identified as primary conduits of such linkages and flows.

The importance of MNEs and their role in promoting economic interdependence among national markets have sparked an active research agenda analyzing their location, control and innovation strategies as well as linkages with the host economies. A number of studies confirm the importance of cluster location for the innovativeness of both domestic and foreign MNEs (Cantwell and Harding 1998; Cook et al. 2013; De Propris and Driffield 2006; Devereux et al. 2007; Enright 1998). Another strand of research uncovers mutual productivity benefits arising between MNEs and the host economy. In particular, a large number of studies provide evidence of the positive impact of multinational presence on domestic productivity and knowledge creation (Driffield and Love 2007; Gorg and Strobl 2001; Havranek and Irsova 2011; Irsova and Havranek 2013) and confirm the existence of *reverse knowledge spillovers* running from the host economy to foreign MNEs. The latter shows that multinationals' location strategies can be guided not only by the firm-specific advantage (FSA) but also by technology-sourcing opportunities (Cantwell and Harding 1998; Mudambi 2008; van Pottelsberghe de la Potterie and Lichtenberg 2001). At the same time, there remains a home country bias in the location of the MNE's most innovative activity (Driffield et al. 2014).

The main conclusion of the above discussion is that productivity growth in every country depends on domestic as well as foreign innovative efforts, where the former are disseminated within the country and the latter are adopted from its trading partners. This chapter focuses on a major advanced economy, the UK. It is still in such economies that the overwhelming majority of innovation takes place. Nevertheless, technologies adopted from abroad are especially important for productivity growth in developing countries with low levels of domestic R&D expenditures and capital stock of knowledge.

This chapter explores the relative importance of several potential influences on productivity growth. Five potential sources are investigated: the accessibility to specialised services and knowledge in the local milieu, broader cluster advantages, spillovers to and from overseas MNEs, global openness of the regional industry in the firm's own line of activity and the global openness of the whole regional economy. This global openness is manifested by the presence of both domestic and overseas MNEs and openness to international trade.

The chapter explores three key questions:

1. Do clusters provide a productivity premium?
2. Does access to sources of information flows promote productivity? In particular, what role is played by knowledge-intensive professional services?
3. To what extent do international linkages promote productivity? In particular, what is the role played by presence of MNEs and openness to international trade?

The rest of the chapter is organised as follows. In "Literature Review", we briefly review the literature and develop the hypotheses to be tested. "Methodology" presents the model and describes our data. "Empirical Analysis and Results" provides the empirical results and "Conclusion" concludes.

Literature Review

Clusters and Innovation

Recent research in the geography of innovation has established several stylised and commonly accepted facts, including (i) innovation is spatially concentrated and (ii) knowledge spillovers are geographically localized (Feldman and Kogler 2010). The idea that FSAs might be developed in strong clusters has been a mainstay of Porter's (1990, 1998) work and that such advantages developed in home markets can be leveraged into overseas markets has a long tradition in theories of the MNE (Dunning 2001). A distinction has long been made in the literature (Hoover 1948) between two potential sources of regional dynamism: urbanization economies, which refer to the benefits of size and diversity of economic activity; and localization economies, which refer to the benefits of large scale *in a particular industry*. This distinction remains important (Feldman 1999).

The significance of clusters is critically related to sources of advantage which are spatially sticky. The literature has placed particular emphasis on complex (Beckmann 2000), tacit (Polanyi 1966) and sticky (von Hippel 1994) knowledge, which is more easily shared in clusters due to the superior ability to form relationships of trust and to establish common frames of reference and a language through which knowledge can be shared. There is solid evidence that there is "decay with distance" in sharing such knowledge (Almeida 1996; Feldman 1999; Smeets 2008). Nevertheless, tacit knowledge may flow internationally, for example, through MNEs, epistemic communities and international networks (Binz et al. 2014; Canter and Rake 2014). Indeed, the importance of external linkages, some at global scale, has been increasingly emphasized in the literature (Bathelt et al. 2004; Boggs and Rantisi 2003).

Another source of stickiness, which is not so obvious, is the labour pool. Very highly skilled labour is a key attraction of clusters. The ability of leading regions in innovation to attract the best innovation talent is an important self-reinforcing dynamic (Miguelez and Moreno 2015). This is an important process through which innovative regions benefit from flows of labour and networks operating at wider spatial scales. MNEs play an important role in two ways. A substantial proportion of international movements of scientists tend to be within a particular MNE. MNEs are able to compete for star scientists. At first glance, such labour does not appear to be spatially sticky as, particularly for elite workers, the labour market is international. Nevertheless, these elite workers will typically only be attracted to certain locations, which have high degrees of agglomeration and sit at the top of the international hierarchy of locations. These locations may differ from industry to industry; however, certain key world cities, of which London is a prime example, have an advantage in attracting such labour. Labour is internationally mobile in a way that *labour pools* are not.

Regarding urbanization economies, Jacobs (1985) lays particular emphasis on the size and diversity of economic activity as being critical to innovation, ascribed to the free interchange of different ideas and the abundance and variety of resources, which may be required as inputs in producing innovation. Both intra-industry knowledge and inter-industry knowledge from more distantly related industries are important inputs to the innovation process (Kafouros et al. 2008; Kotabe et al. 2007). This gibes with Hedlund and Rolander's (1990) argument that in order to foster the creation of new opportunities through innovation, MNEs need to tap into ideas from outside the more narrow scope of their current operations.

H1: Location in a strong cluster will promote higher levels of productivity growth.

MNEs, Spillovers and Reverse Spillovers

The traditional view suggests that technologically superior foreign MNEs can stimulate innovative activity as well as agglomerations/clusters in the host economy (Markusen and Venables 1999). Gorg and Strobl (2001) and Havranek and Irsova (2011) provide comprehensive analysis of the empirical literature on productivity spillovers running from FDI to local firms. In particular, based on the analysis of 3626 estimates, the authors confirm positive spillovers to local firms. Some recent studies (De Propris and Driffield 2006) have also shown that MNEs generate technology spillovers with further agglomeration/cluster effects only in pre-existing clusters, pointing out the spatial limitations of the spillover effects (Devereux et al. 2007). There are a number of channels through which spillovers may arise. Casual exchange of information was famously identified by Saxenian (1994), whereby engineers from competing firms would meet socially and talk about things they were working on. Movement of labour from one firm to another is less bound to a single place, but more likely to arise in a particular locality (Almeida 1996). MNEs may share technology with suppliers and customers, but particularly the former (Almeida 1996). Smeets (2008), in his review of the literature, identified that there is positive evidence for the importance of backward linkages to suppliers, labour mobility and demonstration effects. Havranek and Irsova (2011) also find stronger evidence for backward linkages being a source of spillovers than forward linkages. Irsova and Havranek (2013), in their meta-analysis, conclude that the average effect of horizontal spillovers is negative.

It is important to bear in mind that some foreign subsidiaries do not transfer technology because they are simply not involved in innovation activities. Likewise, some domestic firms are not capable of, or even interested in, exploiting technology spillovers. This means that aggregate studies which cannot distinguish between the two types of foreign and domestic firms will tend to find weaker evidence of spillovers (Gorg and Strobl 2001). Spillovers may not arise in practice, because not all subsidiaries have access to technology residing elsewhere in the MNE and when they do, they often go to considerable lengths to prevent unintended leakage of that knowledge (Driffield et al. 2010). Sofka et al.'s (2014) results indicate that MNE subsidiaries have twice the intensity of protecting R&D compared to the average firm in their industry. MNEs with particular technological strength also tend to locate overseas subsidiaries away from key competitors (Singh 2007). Domestic MNEs as well as foreign MNEs may also be sources of spillovers, given that they possess key sources of competitive advantage, which in many cases will be related to technology.

H2a: A stronger presence of foreign MNEs within a location will promote productivity growth

H2b: A stronger presence of domestic MNEs within a location will promote productivity growth

Internationalization is seen as an important advantage of being an MNE, whether that MNE is domestic or foreign (Kafouros et al. 2008, 2012), albeit that it depends in part on the ability of overseas subsidiaries to embed themselves in external networks and to leverage such knowledge gained within the firm by developing effective internal networks (Frenz and Ietto-Gillies 2007; Hedlund and Rolander 1990; Jenkins and Tallman 2010; Lee 2009). Hitt et al. (1997) argue that multinationals have particular advantages of access to innovative activity at a range of locations, access to resources to devote to R&D, the ability to coordinate innovation across national borders and the ability to defray R&D costs across the range of national markets they sell in. The benefits of location and belonging to an MNE may be more likely to show up in enterprises belonging to domestic MNEs. Overseas MNEs investing in a particular local industrial system may find it difficult to embed themselves (De Propris et al. 2005; Tavares and Young 2005). Overseas subsidiaries may, at least initially, lack the cognitive and organisational proximity required to fully exploit potential knowledge spillovers in an agglomeration (Dangelico et al. 2010; Foss and Pedersen 2002; Song et al. 2011). This "liability of foreignness" that overseas MNEs face (Zaheer 1995) also relates to the importance of trust and social capital in promoting the willingness to share information (Cainelli and Iacobucci 2009).

There is, therefore, an important asymmetry between overseas subsidiaries and enterprises belonging to domestic MNEs and Uni-national Enterprises (UNEs), who do not face such liabilities of foreignness. However, overseas subsidiaries may have offsetting advantages in terms of other influences on absorptive capacity, particularly the prior stock of knowledge, quality of human capital and the organisation of R&D and innovation (Dunning and Lundan 2008; Hymer 1976). Inward FDI into the UK goes back a long way; therefore, many subsidiaries of foreign MNEs have had ample time to embed themselves. The degree of liability of foreignness is also apt to vary with institutional distance and the "distance" of local knowledge from the subsidiary's existing stock of knowledge (Cantwell and Mudambi 2011). Moreover, leading MNEs may embed themselves quickly if their reputation draws local enterprises to cooperate with them (Mudambi and Swift 2012). Entry by acquisition, the most common entry mode for FDI, is also likely to reduce the liability of foreignness.

H3a: Foreign MNEs will gain a productivity premium from location in areas with high access to knowledge

H3b: Domestic MNEs will gain greater benefit than foreign MNEs from location in areas with high access to knowledge

Access to International Knowledge and Innovation

International linkages, both directly in R&D and indirectly via market linkages, may enhance the innovation performance of firms (Cantwell and Janne 1999; Criscuolo et al. 2005; Frenz and Ietto-Gillies 2009). Cantwell and Piscitello (2015) argue that the more internationally open the business networks are, in the area in which the firm is located, the more likely it is that it will access a larger amount of global knowledge. Learning from overseas can also arise through export and import activity (Branstetter 2001; Keller 2004; MacGarvie 2006). It is reasonable to argue that such learning will be directly related to the extent of export and import activity. In an open economy, knowledge spillovers associated with international trade come in the form of the three main channels (Grossman and Helpman 1991). First, international trade allows an increase in the variety of intermediate inputs and capital equipment used in the production process (learning-by-importing). Second, it provides access to the new production methods, managerial practices and product designs, which in turn leads to better use of local resources and better product mix, and finally results in higher productivity (learning-by-exporting). Third, international trade gives an opportunity to imitate foreign technologies and adjust them to domestic production, which is especially important for less-developed countries. International trade eventually increases a country's productivity in imitating foreign technologies or developing new ones, thus raising the country's productivity level.

H4a: A greater degree of openness to trade in a particular location, the higher will be productivity growth

H4b: A greater degree of openness to trade in the firm's own line of activity in a particular location, the higher will be productivity growth

Methodology

The study uses the UK section of the ORBIS dataset that contains information on private manufacturing and service firms operating in the UK. The data include information on around 100,000 UK companies operating in agricultural, manufacturing and service sectors. The data cover the majority of UK manufacturing firms with ten or more employees and provide detailed information on the firms' value added, cost of intermediate inputs, number of employees and total employment costs, tangible and intangible assets, ownership structure, location and industry classification. A brief summary of the main variables used in the analysis is given in Table 10.1.

The geographic unit of analysis is the NUTS2 region, which strikes a balance between being small enough to encompass localized processes, but large enough to avoid serious problems of spatial autocorrelation. The dataset provides comprehensive representation of the total population of MNEs operating in the UK and covers all the UK NUTS2 regions. Geographical distribution of the firms included in the ORBIS dataset is given in Fig. 10.1. As can be seen from the map below, the distribution of firms in the ORBIS dataset is similar to the distribution of firms provided by the Office of National Statistics.

Table 10.1 Summary statistics

Variable	Obs.	Mean	Std. dev.	Min.	Max.
Turnover	98,021	70,522	1,159,434	0	198,362,000
Employees	98,021	329	3603	10	412,574
Export revenue	98,021	4588	98,002	0	10,551,809
Employment costs	98,021	10,632	115,003	9	9,091,242
R&D expenditure	98,021	22,007	230,399	0	4,981,260
Raw materials	551	72,249	663,796	3	11,742,000
Fixed assets	98,021	965,255	8,519,089	2	247,855,590
Intangible assets	98,021	381,472	5,350,349	0	171,739,365
Revenue	98,021	1,123,927	8,018,185	0	198,362,000
Cost of good	1148	−818,132.2	6,341,729	2	155,445,000

Notes: All financial variables are given in thousands USD
Source: Orbis, 2003–1998

The chapter also uses three proxies for cluster strength.

– Total employment in the NUTS2 region. This is an absolute measure of urbanization externalities (and also a proxy for the strength of regional demand);
– Herfindahl–Hirschman Index (HHI). This is a standard relative measure of urbanization economies (industry diversification); the smaller the index, the more diversified is the local economy;
– Location quotient. This is the share of industry *i* in regional employment in region *j* divided by the share of industry *i* in overall national employment. A value greater than 1 indicates that a region has a disproportionate amount of employment in industry *i*. This is a standard relative measure of Marshallian externalities.

The geographical distribution of employment by NUTS2 UK regions is presented in Fig. 10.2. Unsurprisingly, there is a close correspondence with the distribution of MNEs in Fig. 10.1.

As mentioned earlier, the study concentrates on three main research questions. The first two questions study the impact of local external knowledge on productivity (measured as TFP growth) of UK-based MNEs distinguishing between domestic and foreign companies, and this is used as a proxy for innovation. Both product/service and process innovations will raise productivity at the firm level. The third question studies the impact of global external knowledge on the innovative activity and efficiency of domestic and foreign MNEs, distinguishing between high- and low-technology industries. The analysis is also extended to include only a sub-sample of persistent innovators.

In our regression analysis, we closely follow the structure implemented by Lööf et al. (2015) and Cantwell and Piscitello (2015). A key variable of

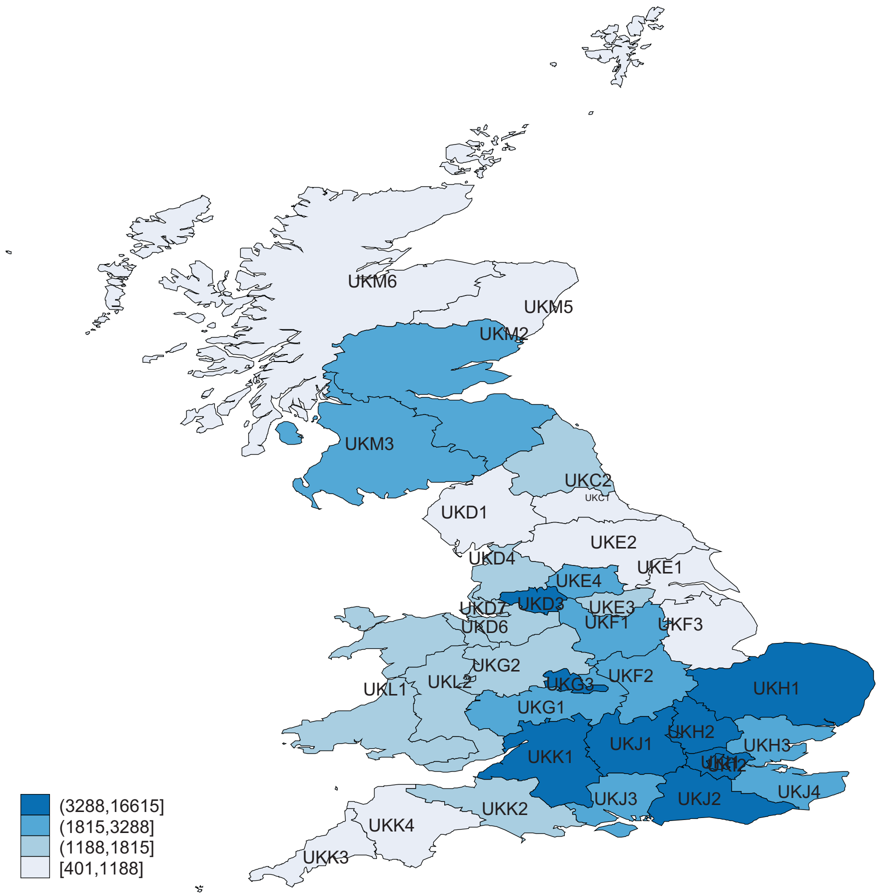

Fig. 10.1 Geographic distribution of firms in the ORBIS database by NUTS2 region 2003–2012

interest in the analysis is the variable that reflects the interaction between the ownership structure (foreign or domestic global owner) and accessibility to knowledge-intensive producer services at the NUTS2 level. The chapter follows Lööf et al. (2015) and identifies 35 knowledge-intensive producer services at the five-digit industry level, which in our version of analysis corresponds to ten knowledge-intense producer services at the two-digit industry level. According to Lööf et al. (2015), the share of employees with a university degree in these sectors is above 30 per cent. Knowledge-intensive producer services include information and communication technologies, R&D-engineering, finance, brokerage and recruitment of personnel. For each of the NUTS2 UK regions, we calculate the number of firms and the

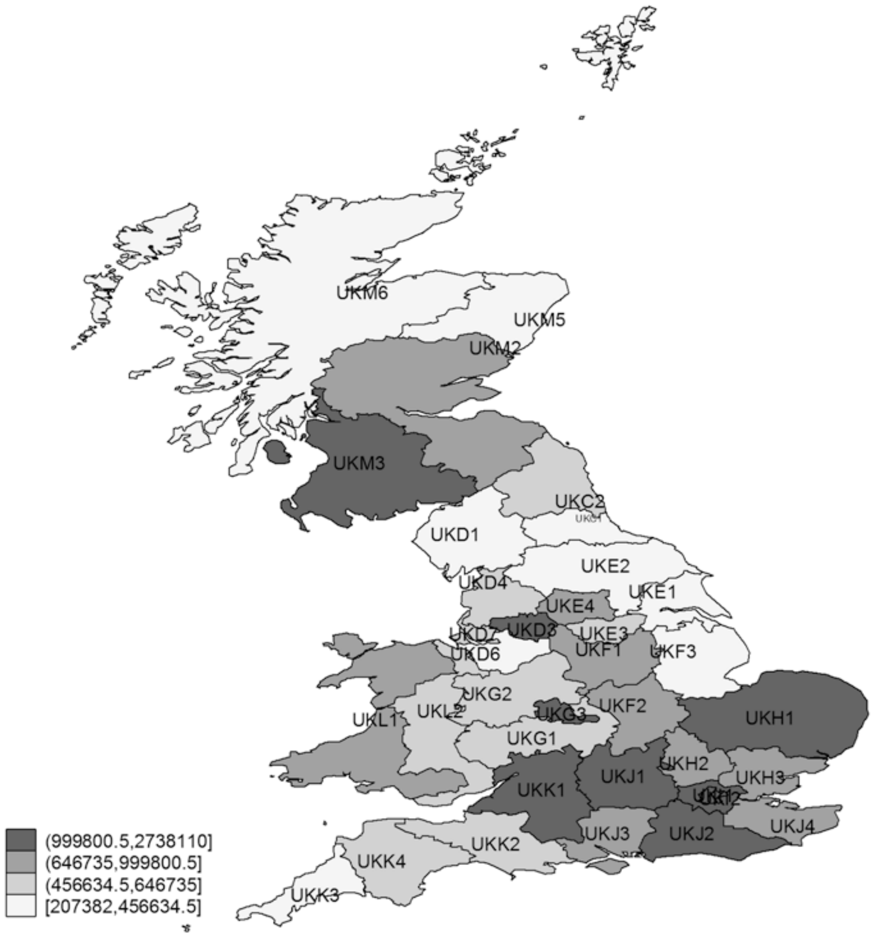

Fig. 10.2 Geographic distribution of NUTS2 regional employment in the NOMIS database, 2011

aggregate number of employees and divide all the NUTS2 UK regions into three quantiles (high, medium and low) based on the number of employees working in the knowledge-intensive producer services sectors located within each region. Regional classification based on knowledge access is presented in Fig. 10.3. Furthermore, we calculate the distance between all the NUTS2 UK regions and those regions with a high concentration of knowledge-intensive producer services. We include these distances in all regressions as additional controls.

We follow Lööf et al. (2015) and create the following control variables *COKA* (corporate ownership and knowledge accessibility):

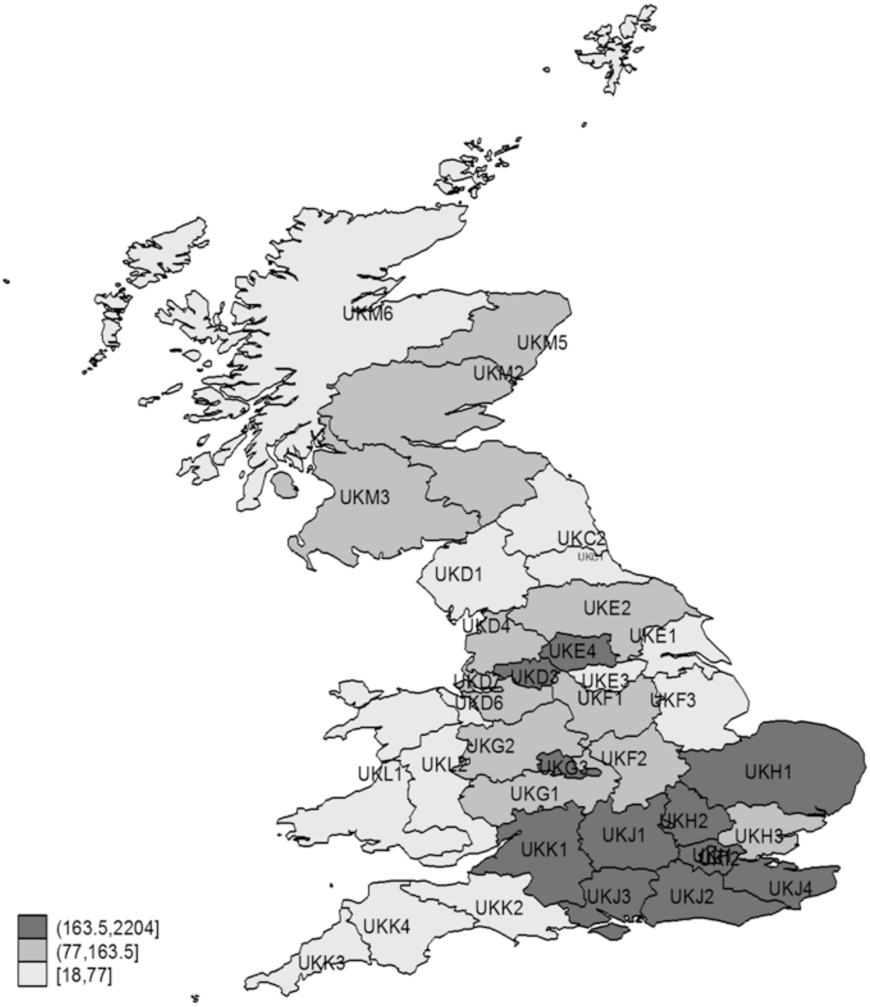

Fig. 10.3 Geographic distribution of firms in knowledge-intense producer service sectors in the ORBIS database, 2003–2012

- *COKA1*—domestic MNE in a low accessibility area
- *COKA2*—foreign MNE in low accessibility area
- *COKA3*—domestic MNE in a medium accessibility area
- *COKA4*—foreign MNE in a medium accessibility area
- *COKA5*—domestic MNE in a high-accessibility area
- *COKA6*—foreign MNE in a high-accessibility area

Finally, we create two additional control variable to reflect the impact of global knowledge spillovers. For that we follow Cantwell and Piscitello (2015) and construct two control variables that measure the relative export intensity of the region of the observed firm and industry of the observed firm:

– *Openness of the local industry*—measures export share of the local industry by the NUTS2 region relative to the export share of this industry in the UK economy;
– *Openness of the local economy*—measures export share of the local economy (i.e. the NUTS2 region where the firm is located) relative to the export share of the UK economy as a whole.

In both cases, the export share of the observed firm is excluded from the measures.

Empirical Analysis and Results

The Model

There are two principal approaches to identifying the existence of spillovers, both based largely on the idea of a "knowledge production function". Some studies look for evidence of improved innovation outcomes, most often patents. Others look for changes in productivity, either labour or total factor productivity, in the firms which are the beneficiaries of spillovers. The latter is used in this chapter. The model is:

$$\begin{aligned}
&lnTFP_{it} = \beta_1 COKA_i' + \beta_2 Openness_1_i + \beta_3 Openness_2_i + \beta_4 e_i + \\
&\beta_4 k_i + \beta_5 Switcher_i + \beta_5 NUTS2_NACE2_Foreign_MNE_{jk} + \\
&\beta_6 NUTS2_NACE2_Domestic_MNE_{jk} + \beta_7 Distance_j' + \\
&\beta_8 NACE2_k + \beta_9 HHI_{jk} + \beta_{10} NACE2_Loc_Quotient_k + \\
&\beta_{11} NACE2_Loc_Quotient_squared_k + \beta_{12} Other_ \\
&Emp_NUTS2_j + \beta_{13} Other_Emp_NUTS2_squared_j + u_t + \gamma_i + \rho_{it}
\end{aligned}$$

$lnTFP_{it}$ is the dependent variable, total factor productivity growth; *COKA* is the main set of control variables classifying the firms into six groups by ownership and local external knowledge accessibility; *Openness_1* and *Openness_2* are the controls of the openness to exports of the local industry and local economy at the NUTS2 level; *Switchers* is a variable controlling for the change of ownership from domestic to foreign and vice versa; *e* and *k* represent firm's employment and capital; *NUTS2_NACE2_Foreign_MNE* and *NUTS2_NACE2_Domestic_MNE* is a number of foreign/domestic

MNEs operating in the same two-digit industry and same NUTS2 region; *Distance*—is the distance to other NUTS2 regions; *NACE2* is an industry dummy; *HHI*—Herfindahl–Hirschman index of industry diversity at the NUTS2 level; *NACE2_loc_quotient*—location quotient on the NACE2 level; *Other_emp_NUTS2*—employment of the NUTS2 region excluding employment of the industry where the firm operates (the squared term is included to capture possible non-linearity). u_t and γ_i are time and firm-specific effects and ρ_{it} is a random error component. The TFP measure was derived as a residual of the standard Cobb–Douglas production function using firm-level value added as a dependent variable and employment, material costs and physical capital as regressors. Robustness checks (not reported) also applied the Levinsohn and Petrin (2003) methodology in order to estimate the firm-level TFP measures, with no significant changes in the results. System GMM was used to account for the two main problems in estimating TFP at the plant level: simultaneity and selection bias.

Results

Table 10.2 presents the results of the estimation of the impact of local knowledge accessibility and global knowledge spillovers on the productivity growth of domestic and foreign MNEs using the system GMM estimator.

Higher levels of regional employment have a positive but almost always insignificant effect on productivity growth. The significance of the regional employment coefficient provides support for Hypothesis 1 only in the case of low-tech industries in the model for all MNEs. At the same time, regional employment does not seem to have any effect on the productivity growth of innovative MNEs. The results including all MNEs confirm a non-significant effect of the presence of domestic MNEs, for both high-tech and low-tech industries. The presence of foreign MNEs exerts a negative effect, significant in the case of low-tech industries. The same signs are preserved in the models with only a sub-set of innovative MNEs, but the results are not significant. This gives no support to Hypotheses 2a and 2b. The estimation results for the whole sample of MNEs indicate that high-tech foreign MNEs in high-accessibility areas have significantly lower TFP growth than the reference group. Such results are preserved when the sample is limited to include only innovating MNEs. When the sample is restricted to include only innovative MNEs, the access to local external knowledge is beneficial for low-tech domestic MNEs in medium- and high-accessibility areas, and for foreign MNEs in high-tech industries in medium accessibility areas. At

Table 10.2 TFP growth, system GMM

	All MNEs		Innovative MNEs	
	High-tech	Low-tech	High-tech	Low-tech
Log TFP_{t-1}	0.262***	0.342***	0.094*	0.153**
	(0.089)	(0.084)	(0.087)	(0.073)
COKA 2	0.429	−0.020	0.034	0.433
	(0.378))	(0.222)	(0.387)	(0.478)
COKA 3	0.129	0.178**	−0.004	0.192*
	(0.179)	(0.075)	(0.118)	(0.104)
COKA 4	−0.103	0.095	0.670*	0.491
	(0.230)	(0.156)	(0.414)	(0.487)
COKA 5	0.112	0.098	−0.024	0.451***
	(0.193)	(0.108)	(0.176)	(0.002)
COKA 6	−0.583*	0.245	−0.749*	−0.756
	(0.329)	(0.196)	(0.447)	(0.680)
Openness of local industry	0.008	0.004***	−0.000	0.001
	(0.018)	(0.000)	(0.002)	(0.001)
Openness of local economy	0.212*	0.103*	−0.133	0.087
	(0.129)	(0.059)	(0.088)	(0.076)
Foreign MNEs in the same	0.001	−0.002***	0.000	−0.001
industry and region	(0.001)	(0.000)	(0.000)	(0.001)
Domestic MNEs in the same	−0.001	0.000	0.001	−0.001
industry and region	(0.001)	(0.000)	(0.001)	(0.001)
Industry dummy	0.004	0.000	0.006*	0.0107
	(0.005)	(0.001)	(0.003)	(0.011)
HHI	89.16**	13.27	97.10***	63.23
	(43.04)	(18.31)	(36.99)	(40.59)
Industry location quotient	0.093	0.037	0.053	0.051
	(0.111)	(0.024)	(0.053)	(0.038)
Industry location quotient	−0.009	−0.001*	−0.001	−0.002*
squared	(0.013)	(0.000)	(0.005)	(0.000)
Regional employment	0.001	0.001**	0.595	0.000
	(0.001)	(0.000)	(0.667)	(0.000)
Observations	172,933	37,409	21,743	8433
Unique firms	51,516	8193	4365	1406
Lag limits	(2 2)	(2 2)	(2 2)	(2 2)
Instruments	103	93	92	81
AR(2)	0.197	0.608	0.637	0.695
Hansen test	0.709	0.962	0.680	0.312

Notes: Standard errors in parentheses ***$p < 0.01$; **$p < 0.05$; *$p < 0.1$. The analysis includes the dummies for distances between NUTS2 regions

the same time, no significant impact was found in the areas with low local external knowledge accessibility. This supports Hypothesis 3b but gives only limited support to Hypothesis 3a.

Furthermore, the results of the estimation on the unrestricted sample indicate that openness of the local economy has a positive and significant effect on the TFP growth of both high-tech and low-tech MNEs, while openness of local industry has a positive and significant effect on the TFP growth of low-tech MNEs only. However, these effects lose their significance when the estimation is performed on the sample with only innovative MNEs. These results give support to Hypothesis 4a, but only limited support to Hypothesis 4b. One possible reason is that innovative MNEs have significant internal resources and capabilities and are less reliant on externalities to innovate. The HHI measure of industry diversity has a positive and significant effect on the TFP growth of MNEs in high-tech industries and this is true for the model using all MNEs and only innovative MNEs. This result, unexpected at the first sight, indicates that less economic diversity in the local economy provides a favourable environment for TFP growth for foreign MNEs, which is more favourable to Marshallian localization effects than to urbanization effects. The location quotient is close to significant and the square of the location quotient is significant for low-tech MNEs, when the estimation is performed on the whole sample. The positive sign on the location quotient and the negative sign on its square indicate a plausible inverted-U relationship, indicating the presence of Marshallian externalities, but with diminishing returns. The location quotient coefficient preserves its sign but is not significant for MNEs in high-tech industries. The coefficients preserve their signs and significance levels when the estimation is performed on the restricted sample of innovative MNEs.

Conclusion

The results of the empirical analysis indicate partial support in favour of Hypothesis 1. Industry diversity has a significant negative impact on the productivity growth of foreign MNEs, and the results are robust even when the estimation sample is limited to include only innovative MNEs. Employment in industries other than the firm's own generally had a significant negative effect. The location quotient showed a plausible inverted-U relationship. Taken together, these results indicate fair support for the importance of Marshallian own industry-specific effects. There was no support for Hypothesis 2a, with a greater presence of foreign MNEs exerting a negative effect on productivity growth. There was also no support for Hypothesis 2b, with a greater presence of domestic MNEs exerting no effect.

Hypothesis 3b, concerning the effect of locating in areas with better access to knowledge-intensive professional services for domestic MNEs, was partially supported, but only for low-tech industries. Foreign MNEs in low-tech industries gained a positive and significant effect on TFP growth from locating in areas with medium access to knowledge-intensive professional services. This provides only very weak support for Hypothesis 3a. The results in support of Hypotheses 4a and 4b are also mixed. Openness of the local economy has a significant positive effect on the TFP growth of both MNEs in high-tech and low-tech industries, but only for the sample of all MNEs. Openness of the local industry has a significant positive effect on TFP growth only for MNEs in low-tech industries in the model using all MNEs, being well short of significance for innovative MNEs.

Overall, the results show weaker effects for the sub-sample of innovative MNEs compared to all MNEs. This is consistent with the idea that innovative MNEs may have superior internal routines and resources and are therefore less reliant on a favourable external environment. The very limited evidence of spillovers emanating from MNEs is consistent with the idea that highly capable MNEs are able to protect their proprietary information.

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11

Noticing and Capturing Growth Opportunities in International Markets: A Real Options Perspective

Ali Ahi and Olli Kuivalainen

Introduction

Entering international markets provide growth opportunities for firms, as different geographies offer divergent growth opportunities and strategies (Tong et al. 2008). To take advantage of such growth opportunities, however, firms face formidable challenges, as aggregated effects of globalization, deregulation, and shortened technology cycles result in an uncertain environment for investment (Krychowski and Quelin 2010). To face such an uncertainty and, at the same time, take these opportunities, real options reasoning (ROR) has proved to be a useful lens (McGrath et al. 2004). According to ROR, opportunities can be considered as options—the firm has the right but not the obligation to decide whether or not to invest in them (Myers 1977). In order to create such growth options, firms often make strategic decisions to invest in international markets with high uncertainty (Kester 1984). The outcome of such decisions is investment in a foreign market in the form of an entry mode. Therefore, ROR is a fruitful lens to study entry mode choice (e.g., Brouthers and Dikova 2010) within the domain of international business (IB), a lens that can advance the growth frontiers in international markets by helping firms to turn potential investment opportunities to real options—as entry modes.

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Critics, however, have questioned the usefulness and applicability of ROR (e.g., Adner and Levinthal 2004b; Garud et al. 1998). For example, in the IB literature, an entry mode has been considered as an option-like form of investment (see, e.g., Brouthers and Dikova 2010; Cuypers and Martin 2010; Jiang et al. 2009). However, as Adner and Levinthal (2004b) argue, such investment decisions are not real options if they are not integrated within the firm's organizational activities. Therefore, they may not provide growth opportunities. If an entry mode offers the firm with an option-like investment, it requires firm's *ex ante* intentionality as to how this mode will provide future value (Adner and Levinthal 2004a). Decision makers in a firm need to be aware that, for example, an international joint venture (IJV) will provide a growth option in the future prior to initiating the IJV. Only then can we consider the IJV as a real option. But where does such awareness come from? How do firms, prior to choosing an entry mode, notice that the mode offers them a real option for further growth? What capabilities should they possess to exercise that option—that is, turn it into real option, taking the opportunity?

We extend the boundaries of ROR in IB to answer the above questions. We suggest that an entry mode chosen by a firm should not be regarded as a real option unless the attention structure of the firm and its capability to notice and exercise that option have been considered. Building on the attention-based view (ABV) of the firm (Ocasio 1997), we argue that noticing a growth option as an entry mode in global markets is dependent on the attention structure of the firm, while the ability to exercise options is rooted in the firm's entrepreneurial orientation (EO)—the decision-making activities leading to new entry (Lumpkin and Dess 1996). Thus, we address an important gap in the literature by encouraging IB researchers to consider organizational factors leading to an option-like entry mode, instead of merely treating the entry mode itself as a real option (see, e.g., Brouthers et al. 2008; Brouthers and Dikova 2010; Cuypers and Martin 2010). Furthermore, the extant literature remains unclear about the performance implications of ROR. Some suggest positive effects (Brouthers and Dikova 2010), while others do not (Reuer and Leiblein 2000). We, however, discuss that an entry opportunity that has been recognized as an option *ex ante* and has been exercised *ex post* as a real option leads to positive performance implication, because it provides upside advantage from the growth opportunity which has been noticed and taken previously.

To explicate our argument further, we also provide examples of two companies' entry approach toward international markets. By comparing these two companies, we show how following the premise of ROR can lead to future growth. Generally, our study enhances the firm's strategic decisions to capture growth opportunities in global markets, specifically markets with high uncertainty.

Background

ROR and Entry Modes as Shadow Options

Real options are specific investments with uncertain payoffs (McGrath et al. 2004). They provide the firm with a right, but no obligation, to scale up or down the investment at a future point in time (Dixit and Pindyck 1994). International investments have option-like properties in which the value is inherent in choices that become available to the firm in the future (McGrath et al. 2004). This provides the firm with the flexibility to decide for a future action, for example, to defer, expand, or abandon the investment (Li and Li 2010). In IB, "option-like entry modes" such as IJVs (e.g., Cuypers and Martin 2010; Kogut 1991), exporting (Lee and Makhija 2009), partial acquisition (Chari and Chang 2009), and greenfield investment (Brouthers and Dikova 2010) have been suggested as offering option-like investment, and thereby future growth opportunities in host markets.

These studies, however, consider entry modes as real options without examining the firm's attention structure and capability to notice and use entry modes as real options prior to making the investment. To a firm, any possible entry mode is a "shadow option", a growth opportunity for strategic choices awaiting recognition (Bowman and Hurry 1993), which turns to a real option, once, and if, it is recognized and later exercised by the firm; only then can it provide a real option (Barnett 2008; Bowman and Hurry 1993). Choosing an entry mode may, or may not, be based on ROR. This can be explained by the distinction between effective versus illusionary real options (Driouchi and Bennett 2012; Garud et al. 1998). While effective real options as entry modes are recognized by the firm prior to being selected, illusionary ones may be chosen, say, based on past experiences (Benito et al. 2009).

On the other hand, ROR does not assign a particular organizational form to the firm (McGrath et al. 2004). Opportunities for growth are available, but remain unnoticed by the firm's decision makers (Barnett 2008). Prior to identifying the available courses of action, managers need to "make sense" of such opportunities as shadow options (Bowman and Hurry 1993). If the firm does not recognize a shadow option as a potential investment opportunity in a foreign market—be it in the form of an initial entry mode or an opportunity to increase investment—it is not following ROR. But how do firms notice shadow options as potential international investment?

Attention Structure of the Firm to Notice Shadow Options

Building on ABV of the firm, Ocasio (1997) suggests that to explain how firms behave, we need to understand how they distribute and regulate the attention of their decision makers. Barnett (2008) argues that the attention structure of the firm plays an important role in enabling it to notice and exercise shadow options. Attention structures, Ocasio (1997, 195) suggests, are "the social, economic, and cultural structures that govern the allocation of time, effort, and attentional focus of organizational decision-makers".

The ABV of the firm holds that organizations are systems wherein attention is processed and distributed (Ocasio 1997). Therefore, the ABV does not treat the firm as a "monolithic" entity, and thus, as suggested by Adner and Levinthal (2004b), addresses one of the major shortcomings of previous empirical ROR research, specifically in IB where the outcome of the firm's decision as an entry mode—dominantly a JV—has been regarded as an option-like choice. Rather, the ABV of the firm sees the organization as more than merely the senior managers (Ocasio 2011); it views organizational attention as a process involving "application of time, energy, and effort" which creates a "pattern or perspective" that becomes the firm's strategy (Ocasio 2011, 1290).

The discussion above sheds light only on the "contextual structure" of the firm's attention, through which the firm defines the boundaries of a wide range of opportunities in global markets (Ocasio 1997). A relevant question, however, is how a firm puts a set of structures which enable it to draw the attention of its decision makers toward new entry in international markets.

Firm's Capability to Exercise Shadow Options

Having noticed a shadow option as a potential investment opportunity in a foreign market, firms need to possess specific capabilities to exercise that option (Garud et al. 1998). EO, which is an internal capability of the firm (Lee et al. 2001), can provide the firm with such important ability. EO refers to "the firm's processes, practices, and the decision-making activities leading to new entry" (Lumpkin and Dess 1996, 136). Entrepreneurially oriented firms focus more heavily on new ventures by supporting related activities such as venturing into unknown markets and introducing new products (Lumpkin and Dess 1996). In an international context, a "new entry" refers to entering to a new market with new or established goods or services (Knight and Cavusgil 2004). Such an EO capability enables the firm to exercise shadow options, boosting firms' growth in global markets (Knight and Cavusgil 2004). Building on EO of the firm, we explain this further.

Noticing and Exercising Shadow Options: The Role of Entrepreneurial Orientation

Noticing Shadow Options in International Markets

What decision makers in a firm do is dependent on where they focus their attention on (Ocasio 1997). Similarly, in order to notice an investment opportunity the firm first needs to focus its attention on it. For instance, when the top management of a firm focuses its attention on searching for new knowledge and information, the overall firm innovativeness is influenced (Li et al. 2013).

The internal and external orientation of a firm's attention structure can be the firm's strategy to explore opportunities for new entry into international markets. For instance, Bouquet et al. (2009) suggest that focusing attention on activities such as global scanning and overseas communications improves the multinational enterprises' understanding of international markets. Such firms generate international attention, enabling them to pursue opportunities in international markets (Bouquet et al. 2009). They possess external attention structure which enables them to spot opportunities as shadow options in these markets as their attention is often distributed and regulated toward international investments (Barnett 2008). In other words, decision makers in these firms direct their attention toward entry into new markets, thus, are more likely to notice shadow options as a new entry mode.

P1: *Firms with international attention are quicker in noticing shadow options in global markets compared to those without international attention.*

Exercising Options in International Markets

Once shadow options are noticed, then they should be exercised (Bowman and Hurry 1993). Only then can we regard them as real options. However, exercising options is dependent on the firm's organizational capabilities (Garud et al. 1998). Therefore, much as it is important to examine the attention structure of the firm to notice shadow options, it is also important to consider the capability of the firm to exercise them.

EO is considered to be an important organizational capability (Knight and Cavusgil 2004; Lee et al. 2001), and firms differ in their capability regarding when and how to exercise available options (Adner and Levinthal 2004b; Kogut and Kulatilaka 2001). To further clarify this, we distinguish between two strands of EO: Kirznerian and Schumpeterian entrepreneurship-oriented behaviour (EOB) (Dutta and Crossan 2005; Shane 2012). Though both reflect the EO of the firm, they are different in a number of aspects (Dahlqvist and Wiklund 2012). As Sundqvist et al. (2012) argue, such differences provide a suitable basis for investigating different firms' behaviour under varying market conditions. Below we detail these differences and their implications on how firms exercise shadow options in global markets.

Kirzner views entrepreneurship as a process in which opportunities are discovered by acting as an *arbitrageur* (Dutta and Crossan 2005). Competitive-oriented activities and entrepreneurial alertness to realize and exploit opportunities are integral elements of this process (Kirzner 1997). Kirznerian firms are market driven and can be characterized as being proactive and competitively aggressive (Sundqvist et al. 2012). Schumpeterian firms, on the other hand, are market-driving firms which disrupt the market equilibration by creating new combinations (Schumpeter 1934; Sundqvist et al. 2012). According to Schumpeter, the entrepreneur, through a discovery process, creates opportunities (Dutta and Crossan 2005). Among the activities on which Schumpeterian firms focus are the firm's ability to launch new products and opening up new markets (Ripsas 1998). This requires innovativeness and risk-taking. Firms with Schumpeterian EOB should also have autonomy to be able to put their innovative ideas into practice (Lumpkin and Dess 2001).

March's (1991) distinction between exploitation and exploration can also be used to distinguish between Kirznerian and Schumpeterian entrepreneurship (Sundqvist et al. 2012). While Kirznerian firms exploit opportunities in their existing markets, Schumpeterian firms explore them in new markets. Kirznerian firms compete aggressively with their rivals, are proactive, and their attention structure is more oriented toward its existing markets. Schumpeterian firms are risk-taking and innovative, and they focus their attention on their external markets, thereby directing their attention toward new markets. Such an attention structure can explain a firm's decision to notice shadow options in existing markets versus new ones (Barnett 2008). This affects how these firms exercise options in different markets.

P2: *Compared to their counterparts with Schumpeterian EOB, firms with Kirznerian EOB are more likely to exercise options in their existing international markets.*

P3: *Compared to their counterparts with Kirznerian EOB, firms with Schumpeterian EOB are more likely to exercise options in new international markets.*

Uncertainty and Shadow Options in International Markets

Operating in international markets is associated with high uncertainty (Kedia and Bhagat 1988). Hence, exercising options in a foreign market is affected by the nature of uncertainty existing in that market. According to ROR, firms face two types of uncertainty in international markets: endogenous and exogenous uncertainty (Chi 2000; Cuypers and Martin 2010). The former can be reduced by the actions of the firm over time and can be resolved by learning through, for example, undertaking a sequential project, while the latter is independent of the firm's action (Folta 1998). For example, demand uncertainty (Brouthers and Dikova 2010), which can be reduced by learning about the market over time, is an endogenous uncertainty, while uncertainty about the exchange rate, over which the firm does not have control, is exogenous to the firm (Cuypers and Martin 2010).

Firms need to be proactive and possess learning capabilities to be able to resolve endogenous uncertainty (see, e.g., Cuypers and Martin 2010). They need to take actions to learn about the market to be able to ultimately resolve the uncertainty (Folta 1998). This can be the result of "proactive" behaviour combined with "aggressively" competing with rival firms in the host market, thereby reflecting the characteristics of Kirznerian EOB. Having noticed a shadow option in a foreign market, such firms are likely to *proactively* exercise the option as a *growth* opportunity in the market, as opposed to wait for the right time to take action. Therefore, Kirznerian firms are more likely to exercise shadow options in markets associated with high level of endogenous uncertainty. This will provide growth options—high commitment mode of entry—offering avenues for further growth.

P4a: *When endogenous uncertainty in a foreign market is high, firms with Kirznerian EOB are more likely to exercise shadow options in that market.*

P4b: *When firms with Kirznerian EOB decide to exercise a shadow option in a foreign market with high endogenous uncertainty, they are more likely to create growth options as opposed to wait-and-see options.*

As Dutta and Crossan (2005, 429) argue, Schumpeter views the entrepreneur as “the innovator who ‘shocks’ and disturbs the economic equilibrium during times of uncertainty, change, and technological upheaval”. Therefore, when exogenous uncertainty, which is independent of the firm’s action and cannot be predicted, is high, Schumpeterian firms are more likely to exercise shadow options. Such firms have autonomy—that is, independent actions to initiate and complete a business concept or vision (Lumpkin and Dess 2001)—to create an act-and-see option (Adner and Levinthal 2004b). As opposed to merely wait-and-see, an act-and-see option is a more proactive type of option which must be designed and planned (Kogut and Kulatilaka 1994). In an international context, this occurs through making a small investment—for example, export operation or licensing—and wait for the right time to strengthen presence in the market. Due to irreversibility of investment in a foreign market (Brouthers et al. 2008) and high costs of withdrawal (Benito and Welch 1997), it is reasonable to create an act-and-see option, which requires lesser commitment, as opposed to growth option, which needs more commitment and is more investment intensive.

P5a: *When exogenous uncertainty in a foreign market is high, firms with Schumpeterian EOB are more likely to exercise shadow options in that market.*

P5b: *When firms with Schumpeterian EOB decide to exercise a shadow option in a foreign market with high exogenous uncertainty, they are more likely to create act-and-see options as opposed to growth options.*

ROR and Performance

Generally, whether following ROR will lead to the firm’s desirable performance is still a subject of debate (Klingebiel and Adner 2015). For instance, Brouthers et al. (2008) and Brouthers and Dikova (2010) suggest that ROR leads to positive effects, while Reuer and Leiblein (2000) remain doubtful. One of the main reasons for these contradictory results in empirical studies may be the failure to consider the attention structure of the firm to notice, and the capability of the firm to exercise, shadow options. In other words, previous empirical work has viewed the firm as a “monolithic” actor or a “unitary” entity (Adner and

Levinthal 2004b), wherein the decisions to exercise options are made regardless of underlying differences in firms' capabilities and structure. As Garud et al. (1998) argue, a failure to consider the organizational design of the firm will lead to potential underestimation of the value of real options for firms which possess the required organizational culture and capability, compared to those which do not possess such attributes. Adner and Levinthal (2004b) also suggest that organizational factors such as the opportunity structure of the firm are important in determining the applicability of ROR.

We respond by discussing that firms differ in their attention structure, thereby differing in their ability to notice shadow options. Moreover, we delineate that firms are different in their capabilities to exercise shadow options noticed *ex ante*. For example, an IJV can be a "false" consideration of option-like investment, if the capability of the firm to exercise that option is not considered. Therefore, we assert that the true performance implications of ROR in firms' decision to enter a market and choose an entry mode can be achieved only when organizational factors are considered.

P6a: *The realistic performance implications of ROR on the firm's decision to enter a foreign market and choose an entry mode can be achieved when the capability of the firm to notice and exercise potential shadow options in the host market is considered.*

As explicated above, once firms follow the premise of ROR in their entry strategy, they avoid downside risk by minimizing the initial investment, but maintain an option for future reallocation of resources, thereby gaining upside potential (Brouthers et al. 2008). However, an entry mode in a foreign market results in the desirable performance provided that the firm notices it *ex ante* as an option-like investment and possesses certain capabilities to exercise the option. Thus:

P6b: *Firms following ROR to choose their entry modes, such that they notice ex ante the entry mode as an option and exercise it ex post based on their capability, achieve positive performance outcomes in international markets.*

Two Contrasting Examples from Business Practice

To elucidate our argument further, we conducted five in-depth interviews—lasting up to two hours—with the top managers of two international companies during 2014–2015. We compare the two companies to investigate how they noticed opportunities of entry into international markets and how they pursued those opportunities—exercised them as real options. We give one example of their entry, argue the differences, and consider the performance implications. We show how this advanced their growth in international markets. Both companies are based in Finland (see Table 11.1 for more details). They were deliberately chosen as they offer contrasting situations in their market entry approach, enabling theoretical replication (Yin 2009).

Company A is active in a niche market offering dual-use products with application in the military. They are "a well-known brand" in their business area (chemical detectors), therefore, are not actively engaged in entering new markets. "We let the customers come to us […] they will find us", as one of the managers said. Given their limited human resources, it is costly for them to systematically search for potential markets: "this just doesn't work that way. We don't search for new markets to enter; rather, customers will find us", noted another manager. They focus on product development and innovation, but to a lesser degree on new market entries. This shows they focus their attention internally as opposed to focusing on external opportunities in global markets.

In the late 2000s, they entered the USA using a sales subsidiary but experienced big losses after a few years. A manager in the company commented that "if we knew that this would be so costly we would have used a partner [e.g., a sales agent or a distributor]". Making decisions in such a way seems to be at odds with ROR, according to which, firms start from sequential and small commitment, and later decide whether or not to reallocate their resources to the investment in the host markets (Klingebiel and Adner 2015). This means that after the initial small investment, they observe the market, and should the uncertainty decrease, they scale up the investment. Or else, there is no obligation to do so.

Company B operates in the mining industry, manufacturing products related to rock and ground drilling. It is not active in a niche market, thus

Table 11.1 Description of the cases

Company	Establish-ment year	No. employees	No. markets	Product type/industry	Foreign sales/total sales (%)	Years of international experience
Company A	1987	58	80	Chemical	90	24
Company B	1985	90	104	Mining	80	28

faces competition globally. Therefore, the management puts effort and spends time to find opportunities to enter international markets. They are also concerned about choosing an appropriate market entry mode. "We are more market-oriented than product-oriented [compared to similar companies in this business]", said one of the managers. They actively analyze international markets, look for possibilities of entry, and examine the risk and uncertainty of a particular entry mode. Therefore, they have an externally oriented attention structure by focusing on external opportunities in international markets.

They entered South Korea via a sales subsidiary when the future was uncertain to them (the manager claimed that at the time of entry, the late 1990s, Korea was an uncertain market to them). Though they encountered minimal losses, they gained market-specific information. Two decades later, they acquired a company in Korea, active in the same industry—mining and drilling. As noted by the manager, "the market was promising […] and we were looking for the most advanced company in the market for a while, and we [finally] acquired one". As Kogut and Kulatilaka (2001) mention, this is a good example of options logic: invest in a sales operation, lose money, but learn the environment to be able to expand in the future should the market grow. ROR seems to be established in Company B and options are intentionally generated and exercised (Barnett 2008). As a manager observed, "we got to know about the mining industry […] and about the market in general, so we knew what would happen if we changed operation mode [before acquiring a firm in the market]".

Company A did not follow ROR when it entered the US market. It entered the market with a big investment, but failed to consider future uncertainties. They were not prepared to go through losses. Company B, on the other hand, chose an entry mode based on the premise of ROR—that is, small initial entry and sequential resource allocation. Therefore, they generated future growth opportunities in the host market and were prepared for uncertainties. They first noticed the opportunity in the market, and then using their resources, they captured the opportunity. Stated otherwise, they turned a potential opportunity into a real option—a real investment with future value—providing future growth frontiers. "We thought of exporting to nearby markets from Korea [before increasing their presence in the market]", the manager told us. They have now made their Korean company a regional hub and currently export to emerging markets in East Asia from their Korean manufacturer. The manager said that they currently even export to markets as far as West Asia; for instance, Iran is a market to which they export regularly from their Korean hub. Following ROR, which allows for long term thinking, Company B first entered one market as a platform for growth in other markets that are still uncertain to them.

Discussion

In this chapter, we examined the application of ROR in the IB literature by showing how the attention structure of the firm as well as its capability can help in noticing—and later taking—growth opportunities as international entry modes. ROR has recently gained popularity in explaining entry mode choice decisions (Cuypers and Martin 2010; Xu et al. 2010). Critics, however, argue that ROR must be integrated within the firm's organizational structure (Adner and Levinthal 2004b) and the firm must be capable to recognize the value of a real option (Garud et al. 1998). This is because a myriad of opportunities as entry modes exist within global markets, but not all are recognized as real options (Barnett 2008). We used ABV and the notion of EO to address the above challenges regarding the applicability of ROR. As entering into international markets is a focal phenomenon in IB that brings future growth, we have also advanced the growth frontiers of IB by showing how firms can turn potential entry opportunities into real market ventures.

We also suggested six propositions. The first argues that firms with international attention are quicker in noticing potential investment opportunities in global markets. This is important as a firm's decision makers, in order to capture upside potential, must quickly notice shadow options throughout their surrounding environment and act upon them—exercise them and turn them into real options (Barnett 2008; Bowman and Hurry 1993). We further argue that firms with EO have the capability to exercise the already recognized shadow options. A firm with an EO capability is more confident in its ability to exploit potential opportunities as shadow options in the international environment (Covin and Slevin 1991). This leads us to propositions 2 and 3 in which we distinguish between Kirznerian and Schumpeterian EOBs. We suggest that Kirznerian firms are quicker in exploiting opportunities (Sundqvist et al. 2012) and are more likely to exercise a shadow option in their existing markets, while Schumpeterian firms explore opportunities (Sundqvist et al. 2012), and therefore are more likely to exercise options in new markets.

Propositions 4 and 5 discuss the effect of the nature of uncertainty on noticing and taking growth opportunities as entry modes. Distinguishing between Kirznerian and Schumpeterian EOBs (Dutta and Crossan 2005; Shane 2012), we argue that Kirznerian firms are more likely to grasp opportunities as real options in environments with endogenous uncertainty as they can proactively take actions to decrease the uncertainty. Schumpeterian firms, however, are more likely to do so when there is exogenous uncertainty in the host markets as they are more risk-taking. Kirznerian and Schumpeterian EOBs provide a framework which fits well into ROR and can provide guidance on how to notice and convert potential opportunities into real options when facing different types of uncertainty. Finally, we argue that following ROR to notice and exercise available options as entry modes bring positive performance implications (proposition 6). In Table 11.2, we summarize our propositions, providing detailed information on how to measure them. Future researchers are encouraged to test our propositions using firms of different sizes and in different industries.

We also provided two illustrative examples to show how firms differ from each other in noticing and exercising growth opportunities as entry modes. A similar entry mode may, and equally may not, be based on ROR. Both Companies A and B used a sales subsidiary as their entry mode, but only one of them had entered with the intention of reallocating resources after actively gaining information about the market, thereby using ROR (Adner and Levinthal 2004a) and achieving the desirable result. Company B had *noticed* the opportunity of expanding its business before entering into the market. Intriguingly, Company B had entered a more uncertain market. As Garud et al. (1998) suggest, it is the perspective of the decision makers which makes the difference. This shows that not only could ROR explain the entry mode decision-making, but it also elucidates the general internationalization strategy and market choice. As in the case of Company B, an initial entry may provide a company with a regional bridgehead. This area can provide further research opportunities for ROR, including how ROR can help firms to spot the opportunities which lead to international growth.

Naturally, our research has limitations. We have applied ROR at the level of the firm, but the decisions to enter a market are made by individuals who are affected by their personal experience, knowledge, and tolerance of uncertainty (Aharoni et al. 2011). Future research can consider these individual characteristics when studying firm's decision-making for noticing and taking opportunities in global markets. Also, the dynamism of EO as a capability could be studied in a more detailed manner.

Table 11.2 Summary of the propositions

Propositions	Analytical themes	Implications	Possible measurement methods
1	Noticing options	International attention boosts noticing of shadow options in global markets	Examining the mindset of top management regarding global markets (Bouquet et al. 2009; Knight and Cavusgil 2004).
2, 3	Exercising options in new vs. existing ones	Kirznerian (Schumpeterian) firms have internal (external) attention structure and more likely to exercise options in existing (new) markets.	Examining proactiveness and competitive aggressiveness for Kirznerian EOB, and autonomy, risk-taking, and innovativeness for Schumpeterian EOB (Jambulingam et al. 2005; Sundqvist et al. 2012)
4 (a & b)	Endogenous uncertainty and Kirznerian EOB	In markets with high endogenous uncertainty, Kirznerian firms are more likely to take advantage of shadow options.	Endogenous uncertainties, among others, are demand (see Brouthers and Dikova 2010), behaviour (see Anderson and Gatignon 1986), and culture uncertainties (see Cuypers and Martin 2010).
5 (a & b)	Exogenous uncertainty and Schumpeterian EOB	In markets with high exogenous uncertainty, Schumpeterian firms are more likely to take advantage of shadow options.	Exogenous uncertainties, among others, are political (see Delios and Henisz 2003), exchange rate (see Cuypers and Martin 2010), and institutional uncertainties (see Brouthers 2002).
6	ROR and performance	Following ROR by considering firm's attention structure to notice and its capability to exercise options lead to positive performance implications.	Measuring the consistency of resource allocation regimes in entry strategy of firms with ROR (see Klingebiel and Adner 2015). Then compare this with the overall satisfaction of managers with their operations abroad.

Conclusion

In this study, we added to the IB literature by arguing that the ability of the firm to notice and exercise potential opportunities—shadow options—depends on its attention structure as well as its EO. Accordingly, we discussed how to avoid misapplication of ROR in IB. ROR is not applicable to all entry mode decisions unless the required organizational factors for its implementation have been considered. Put differently, entry modes as potential growth opportunities in international markets are available, but not all firms possess the attention structure and the capability to notice and exercise them. Building on ABV and EO, we discussed this further. We also showed how this has positive performance implications for the firm. Our research ultimately advances growth frontiers in IB. This, too, will help practitioners to enhance their presence in international markets, especially those with high uncertainty.

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Part IV

Ethical Growth Avenues

12

Civil and Political Liberties and FDI: An Evaluation of Emerging and Developing Economies

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Introduction

Foreign direct investment (FDI) has been embraced as a key driver of economic development and growth in host economies (El-Wassal 2012; Solomon and Ruiz 2012; Baek and Qian 2011), and governments across the globe have strived to put in place policies to improve their countries' attractiveness for FDI (Solomon and Ruiz 2012; Baek and Qian 2011). Given the role of FDI as a factor that promotes industrialization and development, especially when the incentives for domestic investment are weak, it is interesting to examine the role of the institutional and political environment in attracting FDI. In recent years, the literature on the determinants of FDI has also shifted its attention towards the institutional factors. A key element influencing the institutional factors in an economy is the level of democracy. Thus far, a number of studies have considered the influence of the level of democracy in host countries on inward FDI and have reported contrasting results. The first group of these studies includes Ursprung and Harms (2001), who find a positive significant relationship, while the second group includes Huntington and Dominguez (1975), Wintrobe (1998) and Greider (1998), who report a negative relationship.

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To explain these inconsistencies, a recent strand of literature has focused on the disaggregated measures that constitute democracy of the host countries, mainly civil liberties and political rights. However, in spite of numerous studies on the topic, the literature on the effect of political and civil liberties on FDI is still far from conclusive. For instance, authors such as Huntington and Dominguez (1975), Wintrobe (1998) and Greider (1998) provide discussions and evidence in favour of the idea that multinational enterprises (MNEs) tend to invest in countries with low level of liberties (countries with high levels of repression), while others such as Olson (1993), McGuire and Olson (1996) and Ursprung and Harms (2001) provide discussions and evidence contrary to the latter, arguing that MNEs invest more in countries where democratic rights of people are respected. Recent studies, including Li and Resnick (2003), Adam and Filippaios (2007) and Asiedu and Lien (2011), tend to provide evidence in favour of the existence of non-linear relationships between the two.

Considering the foregoing, this research aims to explore the effect of the level of civil liberties and political rights of host countries on their inward FDI activity in terms of jobs created. We argue that the effect of civil liberties and political rights will depend on the motivations of MNEs investing and will have a strong impact on the jobs created, leading to enhanced economic growth for the recipient location. We also argue that there is a positive moderating effect from the existence of human capital (semi- and highly skilled) on the effect of political rights and civil liberties suppression on the jobs created.

We empirically test our hypotheses on a large sample of approximately 35,000 investment projects in 110 developing and emerging economies over the period 2003 and 2013. We have collected data from over ten home locations covering a variety of developed and developing investors. To the best of our knowledge, this is the first time a study uses data at the individual investment level, and we provide a holistic approach to the analysis of the effect of political rights and civil liberties suppression, by covering a substantial number of home and host locations as well as industries over an extended period of time.

We therefore contribute to the literature in two ways. Conceptually, we explain the effect of civil liberties, by arguing on the existence of a moderating effect from the human capital. Empirically, we evaluate our hypotheses using an extended sample that can offer a number of insights on home, host locations as well as different industries.

The remainder of this chapter is structured as follows: The next section will offer a literature review of the phenomenon under investigation and will highlight the key inconsistencies found. “Conceptualization” will present our conceptual framework, the key arguments and the development of our hypotheses. "Methodology and Sample Description" will present the methodology followed and the key characteristics of our sample. The next section will present and discuss the results, whilst "Conclusion" will conclude the chapter and offer possible future research directions.

Literature Review

A number of studies have attempted to examine the relationship between FDI and democracy through different lenses. Some papers focus on the effect of the overall democracy on FDI, whilst others focus on its two components, that is, civil and political liberties. Finally, some papers include only one of the two components, arguing on its impact on FDI. The following literature review will provide evidence of these different approaches and help us, through the variety of results, to justify the need for further conceptual and empirical work in the area.

FDI and Democracy

A seminal paper in the literature on the effect of democracy and FDI is the one by Ursprung and Harms (2001), which explores the relationship between democracy and FDI, with the main intention of examining whether the popular view that "political repression boosts FDI" holds. They consider 62 developing and transitional economies for 1989–1997 and find that contrary to the above-mentioned view, MNEs tend to be attracted by countries in which civil and political liberties are respected. Using both aggregated and disaggregated measures of democracy and civil and political liberties, Busse (2004) investigates the impact of the level of civil and political liberties as well as the quality of institutions on FDI. He finds evidence of a positive significant relationship between democracy and inward FDI. Therefore, his empirical findings support the findings of Rodrik (1996) and Harms and Ursprung (2002) that MNEs are attracted by countries where democratic rights are protected. Busse and Hefeker (2007, p. 397), in a similar attempt, explore the linkages between institutions, political and civil rights and FDI inflows using a panel of 83 developing countries from 1984 to 2003, and they find that "government stability, internal and external conflict, corruption and ethnic tensions, law and order, democratic accountability of government, and quality of bureaucracy are highly significant determinants of foreign investment inflows".

Other studies, including Asiedu and Lien (2011), Adam and Filippaios (2007), and Li and Resnick (2003), that investigate the effect of the level of democracy in host countries on FDI generally find non-linear relationships. For instance, Asiedu and Lien (2011) examine the relationship between democracy and FDI and find that democracy's effect on FDI is conditional on the share of natural resources in the host countries' total exports. Another example of such non-linear relationships reported when democracy and FDI are considered is the work of Adam and Filippaios (2007), which explores the effect of the level of democracy on FDI by decomposing democracy into two main elements of civil and political liberties. Using panel data of 105 developed and developing countries for 1987–1997, they find that there is a negative relationship between civil liberties and FDI, which is hump shaped (there is a threshold level below which repression of civil liberties is associated with more FDI). With respect to political liberties, they find that there is a positive significant relationship between political liberties and FDI. Therefore, they conclude that MNEs tend to invest in countries with low civil but high political liberties. The final example of studies that have found a non-linear effect between democracy and FDI is that of Li and Resnick (2003). In an empirical attempt to investigate the influences of the existence of democratic institutions on inward FDI, Li and Resnick (2003) find that both property rights protection and democracy-related property rights protection encourage FDI inflows, and that democratic institutions improve private property rights protection. On the other hand, they find that democratic institutions reduce FDI through other channels, that is, provision of capital controls.

FDI and Political Liberties

Jensen (2003) empirically explores the effect of political conditions of a country on the FDI inflows using both cross section and panel analysis for 114 countries and finds that democratic governments attract higher levels of FDI. Others, such as Addison and Heshmati (2003), investigate the determinants of FDI inflows to developing countries (72 developing countries), using the data from 1970 to 1999 and find that democratization leads to an increase in FDI inflows to developing countries. Asiedu (2006) empirically investigates the influence of political risk, institutional framework and government policy on FDI using a sample of 22 countries in Sub-Saharan Africa from 1984 to 2000 and finds that an efficient legal system and a good investment regulatory framework promote FDI, whereas political instability discourages FDI. Other scholars, such as Bandelj (2002), adopt a more holistic approach and consider not only the political risk but also the effect of social relations on FDI, and they find that while political alliances, cultural ties and the presence of networks between countries shape FDI flows, political risk is only a significant influential host characteristic in the absence of relational factors, and insignificant when relational predictors are added to the model. Finally, Baek and Qian (2011), investigating the effect of political risk on FDI using a sample of 116 countries over the period of 1984–2008, find that political risk is a significant determinant of FDI in both industrialized and developing nations. Coates et al. (2010), investigating the effect of existence of interest groups on FDI activity using an unbalanced sample of 128 countries from 1985 to 2004, over three time periods, find that higher political liberties that lead to the existence of interest groups are negatively related to investment.

FDI and Civil Liberties

A number of studies have also focused on the influence of civil aspects of institutional environment. These studies have found results supporting a range of outcomes on the relationship between the civil aspect of the quality of institutions and FDI. Pournarakis and Varsakelis (2004) investigate the factors leading to the uneven allocation of FDI in economies of transition. Considering the period of 1997–2001, they find that a higher level of civil rights in a country and better quality institutions have an indirect positive effect on FDI. In a more detailed study, Coughlin et al. (1991) investigate the factors influencing the location decision of foreign investors when investing in various states of the USA, using data from 1981 to 1983, and find that higher unionization rates are associated with increased FDI. Blanton and Blanton (2007) examine the impact of human rights on FDI inflows (both direct and indirect) and empirically show that human rights have both direct and indirect effects on FDI, with repression negatively related to FDI inflows. They find "human rights significantly related to human capital" and that, through human capital, human rights have a significant indirect effect upon FDI. In regard to the influence of democracy and democratic institutions on inward FDI, they find a positive insignificant relationship. In contrast, Coates et al. (2010) investigate the effect of interest groups and their activities on FDI by considering a panel data of 126 countries for 1985–2004 and report findings that are consistent with Olson's hypothesis: the number of interest groups in a nation is negatively correlated with investment and consistent with a sclerotic effect due to rent-seeking by interest groups.

Conceptualization

We argue that in order to explain the impact of political rights and civil liberties on FDI decisions, we should take into consideration the motivations driving FDI. MNEs tend to invest in different countries on the basis of resource-, market-, efficiency- and strategic asset-seeking motivations. Even though higher political rights and civil liberties typically imply better democratic institutions, there is no reason to expect that these two liberties affect the investment motives of the MNEs alike. Civil liberties refer to the workplace environment and the organization rights of the workers and to various economic rights. In contrast, political rights refer to the decision-making process in the country and the way the government chooses which policies to implement.

Huntington and Dominguez (1975) started a discussion by claiming that autocratic rulers provide a better economic environment for both domestic and foreign investment since they are more able to enact efficiency-enhancing policies. Rodrik (1996) investigated the relation between democratic rights and FDI that originated in the USA and supported the hypothesis that countries with weaker democratic rights attract less US capital. But following Olson (1993) and McGuire and Olson (1996), there is a risk of policy reversals in dictatorships and lack of credibility in countries with weaker democratic rights.

Political liberties' repression effect on FDI, thus, comes through a different channel. It is established in the literature (Ferejohn 1986; Drazen 2000) that elections act as a disciplining device for the policymaker. When elections are free and fair, voters will punish the officeholders that deliver "bad" economic outcomes. This will induce the officeholder to provide sound economic policies. In support of the above argument, Olson (1993) and McGuire and Olson (1996) argue that non-democratic autocratic rulers have a shorter time horizon since policy changes, for example, due to a violent revolution, are more frequent in non-democracies. The above suggests that in countries where political liberties are low—that is, the electoral mechanism does not work efficiently—economic policies and outcomes are less efficient compared to policies in countries with high political liberties. Less efficient government policies have a negative effect on the returns of FDI and therefore reduce the amount of FDI that a country receives. On this basis we formulate our first hypothesis:

H1: *The suppression of political rights reduces the amount of FDI attracted in a location.*

Borensztein et al. (1998) suggest, based on their work, that FDI has a stronger impact on domestic investment, if the country is over a certain threshold level of human capital. Given the existence of such circumstances, the FDI–growth relationship is enhanced. The local country's level of human resources, thus, plays an important role for FDI inflows into an economy. Dunning (1988) tested the effect of skill and educational level as requirement for FDI inflows. Noorbakhsh et al. (2001) go a step further and define human capital as one of the most important determinants for FDI inflows. However, even if the human capital provides the necessary preconditions for FDI inflows, Katz (2004) showed in his study on Oman that the poor status of political rights and civil liberties is considered as a limitation for FDI inflows.

On this basis, we argue that high repression of civil liberties is expected to exert a negative effect on the productivity of the workforce. In such an environment, workers are not accustomed to taking initiatives, cannot co-operate effectively, and have lower incentives to be productive. This implies lower returns to foreign investments. In such cases, an increase in economic rights and civil liberties may stimulate the working of the free market, providing better outcomes for productivity and growth (Friedman 1962). On this basis, we formulate our second hypothesis:

H2: *The suppression of civil liberties will reduce the amount of FDI attracted in a location.*

As civil liberties rise, the productivity of the workforce increases, but at the same time adverse powers may come into play. Labour unions and special interest groups begin to form and gain power, increasing their ability to extract economic rents from the MNEs. The above non-linear effect of a change in civil liberties on the level of FDI is similar to the non-linear relationship between civil liberties and growth verified in many empirical studies (see Limongi and Przeworski 1993). We therefore formulate a third hypothesis:

H3: *The existence of high levels of human capital will positively moderate (enhance) the relationship between civil liberties and FDI.*

Methodology and Sample Description

Variables and Sample Description

To empirically evaluate our hypotheses, we adopt a quantitative approach. The database used in this chapter is unique and covers FDI made by a number of investing countries in a large number of developing and emerging markets. More specifically, we have collected data from FDI Markets, a database provided by *Financial Times* that covers investment decisions globally from 2003 onwards. Given the nature of our research, we measure FDI inflows by the jobs created by each project. We have selected a number of home (investing) locations to allow for potential variety of approaches. More specifically, we have included investments from the countries presented in Table 12.1 covering a wide range of developed and developing countries. Our recipient economies consist of 110 countries with a wide coverage of the different continents.[1]

Table 12.1 FDI projects included in the analysis

Home country	Number of projects	Total jobs created	Average jobs per project	Total capital invested (US$ in million)	Average capital invested per project (US$ in million)
Canada	1565.00	403,573.00	257.87	203,314.05	129.91
China	1057.00	411,229.00	389.05	148,865.26	140.84
France	4393.00	980,429.00	223.18	300,924.13	68.50
Germany	7273.00	1,567,548.00	215.53	393,281.01	54.07
India	1674.00	321,881.00	192.28	125,453.74	74.94
Italy	2091.00	460,448.00	220.20	145,737.95	69.70
Japan	6345.00	1,710,261.00	269.54	421,610.11	66.45
Russia	964.00	195,570.00	202.87	97,364.21	101.00
South Korea	1558.00	647,072.00	415.32	182,280.94	117.00
Spain	2734.00	578,749.00	211.69	170,458.47	62.35
UAE	1438.00	382,398.00	265.92	191,550.36	133.21
UK	5975.00	1,1048,19.00	184.91	366,500.50	61.34
USA	16,694.00	3,527,618.00	211.31	983,760.59	58.93
Grand Total	53,761.00	12,291,595.00	228.63	3,731,101.29	69.40

[1] The list of recipient countries can be found in Appendix 1.

The projects included in our analysis were performed between January 2003 and December 2013 and have created over 12 million jobs in the recipient economies. By far the biggest investor in terms of the number of projects is the USA, with almost a third of all projects, followed by Germany, Japan, the UK and France. On average, each project has created over 228 jobs and was worth approximately US$ 70 million. Finally, it is interesting to note that South Korean and Chinese projects are on average bigger than the rest of the countries both in terms of average jobs and average capital invested.

Our main independent variable capturing the political and civil liberties suppression comes from the annual publication of Freedom House. We measure civil and political liberties using Gastil's Index as published by the Freedom House Foundation. Freedom House is a non-governmental organization that, since 1972, rates all countries according to their democratic institutions. Two indices are reported, one for political rights and one for civil liberties. Each index takes a value from 1 to 7, with a rating of 1 for countries with political and civil liberties that come closest to the ideals and 7 for countries with absence of all democratic rights. The political repression index is constructed according to the status of the elections and the constitutional role of the elected government in decision-making. The civil repression index measures the lack of various civil liberties. Despite their high correlation,[2] these two indices measure different aspects of democracy and, according to our hypothesis, have a differential impact on FDI. To complement these measures of political rights and civil liberties suppression, we also measure institutional quality using a composite measure combining a number of facets of institutional environments. The data come from the International Country Risk Guide and, in particular, the political risk components. These cover elements such as Government Stability, Socioeconomic Conditions, Investment profile, Internal and External Conflict, Corruption, Military and Religion in Politics, Law and Order, Ethnic Tensions, Democratic Accountability and Bureaucratic Quality. Low values of this measure indicate a lower institutional quality and thus higher risk to potential investors. In Table 12.2, we provide some statistics on the average political rights, civil liberties and institutional quality of the different host economies by investor.

The United Arab Emirates, South Korea, India and Japan tend to invest in countries with relatively suppressed civil liberties; the picture is similar, with the addition of France and Russia, when it comes to political rights. China and the United Arab Emirates are the two cases that tend to invest in countries with low levels of institutional quality. From Table 12.2, no particular

[2] The correlation matrix for our dependent and independent variables can be found in Appendix 2.

Table 12.2 Average political rights, civil liberties and institutional quality of host locations (by investing country)

Home country	Civil liberties suppression (average of host locations)	Political rights suppression (average of host locations)	Institutional quality (average of host locations)
Canada	3.66	3.83	67.31
China	3.64	3.77	65.41
France	3.75	4.06	68.12
Germany	3.28	3.45	69.11
India	4.28	4.67	68.59
Italy	3.55	3.79	68.22
Japan	4.28	4.69	66.83
Russia	3.62	4.04	66.77
South Korea	4.29	4.75	66.57
Spain	3.16	3.22	67.96
UAE	4.60	4.84	64.43
UK	3.73	3.92	68.88
USA	3.79	3.93	68.31
Grand total	3.77	3.99	68.01

pattern appears to have emerged with regard to host country effects on civil liberties, political rights and institutional quality.

To measure the level of human capital in the host economies, we have used the gross enrolment in secondary and tertiary education. The levels of the secondary education capture the semi-skilled labour force, whilst the levels of tertiary education capture highly skilled labour force. Whilst a number of alternative indicators exist that could potentially capture the human capital in an economy such as the human development index and the proportion of labour force with secondary and tertiary education, these were not selected for our analysis on the basis of overlap with other variables such as labour cost for the human development index and scarce availability of data for the proportions of the labour force with different levels of education. We present some basic statistics on the host locations for these key variables in our analysis in Table 12.3.

For both political rights and civil liberties suppression, there was a general improvement between 2003 and 2013, with civil liberties performing better. Contrary to this positive picture, there was a deterioration of the level of institutional quality during the same period. Also significant was the improvement of the skills of the population in the different host locations, with gross enrolment in secondary education increasing from 74 per cent to 93 per cent and the gross enrolment to tertiary education following with an increase from

Table 12.3 Average political rights, civil liberties, gross enrolment in education, jobs created and capital invested between 2003 and 2013

	2003	2013	Overall average
Political rights suppression	3.98	3.86	3.99
Civil liberties suppression	3.98	3.77	3.76
Institutional quality	68.91	65.08	68.01
Secondary enrolment	74.45	93.60	80.84
Tertiary enrolment	31.50	41.95	36.48
Jobs created	266	183	228
Capital invested	85.59	55.79	69.40
Projects	4140	5900	

32 to 42 per cent. These two figures demonstrate that the major improvement took place in the creation of semi-skilled and less in the creation of highly skilled workforce. During the same period, the average size of projects dropped both in terms of jobs created and capital invested despite the significant increase in the number of projects.

Finally, we have included a number of control variables in our analysis to capture the size of the economy (GDP), the labour cost of production (GDP per employee), the agglomeration of FDI (FDI inflows), the trade openness of the economy (Trade), the ores and metals exports (Ores and Metals Exports) and fuel exports (Fuel Exports), to capture the existence of natural resources and therefore resource-seeking FDI in the host economies. Table 12.4 summarizes the key variables used and provides the relevant data sources.
The summary statistics of our dependent and independent variables can be seen in Table 12.5.

Unfortunately, despite the high number of observations on our dependent variables, data limitations, especially with regard to variables capturing the existence of human capital in a host location, mean that our usable sample is significantly smaller.

Estimation Method

Our sample consists of a series of individual investments across locations over a number of years. As such, it is not a panel dataset and, therefore, applying panel data estimation methods would be inappropriate. We decided to proceed with a pooled OLS estimation by including year and industry effects. In all estimations, we report the F-statistic associated with the time and industry effects. We have also used White-corrected standard errors to control for heteroscedasticity. Both the dependent variables and the GDP, from the

Table 12.4 Definitions and sources of variables

Variable	Definition	Source
Jobs created	Jobs created by project	FDI Markets
GDP	GDP, PPP (constant 2011 international $)	World Development Indicators
GDP per person employed	GDP per person employed (constant 1990 PPP $)	World Development Indicators
FDI Inflows	FDI, net inflows (% of GDP)	World Development Indicators
Trade	Trade (% of GDP)	World Development Indicators
Ores and metals exports	Ores and metals exports (% of merchandise exports)	World Development Indicators
Fuel exports	Fuel exports (% of merchandise exports)	World Development Indicators
Gross enrolment ratio, secondary	Gross enrolment ratio, secondary, both sexes (%)	World Development Indicators
Gross enrolment ratio, tertiary	Gross enrolment ratio, tertiary, both sexes (%)	World Development Indicators
Institutional quality	Composite measure of institutional quality that includes: Government Stability, Socioeconomic Conditions, Investment profile, Internal and External Conflict, Corruption, Military and Religion in Politics, Law and Order, Ethnic Tensions, Democratic Accountability and Bureaucratic Quality Takes values 0–100 with lower values indicating lower institutional quality	International Country Risk Guide
Political rights suppression	Composite index capturing: Electoral Process, Political Pluralism and Participation, and Functioning of Government Takes values 1–7 with higher values indicating suppressed political rights	Freedom House
Civil liberties suppression	Composite index capturing: Freedom of Expression and Belief, Associational and Organizational Rights, Rule of Law, and Personal Autonomy and Individual Rights. Takes values 1–7 with higher values indicating suppressed civil liberties	Freedom House

Table 12.5 Summary statistics

Variable	Obs	Mean	Std. dev.	Min	Max
Jobs created	53,761	228.63	463.65	0.00	19,000.00
Capital invested	53,761	69.40	275.76	0.00	20,000.00
GDP	52,879	3020.00	3930.00	1.72	16,000.00
GDP per person employed	52,552	16,970.95	10,595.55	663.00	51,860.00
FDI Inflows	53,605	4.47	5.93	−16.09	173.45
Trade	53,408	89.16	72.36	0.31	439.66
Ores and metals exports	51,195	5.43	8.70	0.00	85.97
Fuel exports	51,221	17.23	23.55	0.00	99.79
Gross enrolment ratio, secondary	39,529	80.84	16.13	7.57	124.61
Gross enrolment ratio, tertiary	42,142	36.48	22.62	0.72	117.89
Institutional quality	53,761	68.01	7.90	24.04	90.92
Political rights suppression	53,709	3.99	2.28	1.00	7.00
Civil liberties suppression	53,709	3.77	1.69	1.00	7.00

independent variables, have been normalized with the use of logarithm. Finally, for the regressions where we include the interaction effects between the civil liberties suppression and the human capital (secondary and tertiary enrolment), we have standardized all three variables with a mean of zero (0) and standard deviation of one (1) in order to facilitate the interpretation of the interaction coefficients. In all cases, we report the *R*-square and the variance inflation factor, which together with the correlation table indicate no multicollinearity problems for our estimations.

Results and Discussion

Our first model in Table 12.6 presents the individual effects of human capital, political rights and civil liberties suppression and institutional quality on jobs created by each FDI project.

As expected, the size of the economy (GDP) has a positive sign and is statistically significant, whilst our labour cost measure, as *proxied* by the GDP per person employed, has a negative and statistically significant effect. Both measures of human capital, enrolment in secondary and tertiary education have negative and significant signs, indicating that the cost of labour and the existence of semi- or highly skilled workers in the economy negatively influence the size of the project in terms of jobs created. Our results also indicate that the institutional quality of the host location positively and in a

Table 12.6 Regression analysis of the effect of political rights and civil liberties suppression on FDI (dependent variable is a logarithm of jobs created)

	Model 1.1	Model 1.2	Model 1.3 CL ≥ 4	Model 1.4 CL < 4
GDP	0.0970 (0.0086)***	0.0952 (0.0087)***	0.1057 (0.0203)***	0.1170 (0.0180)***
GDP per person employed	−0.0041 (0.0014)***	−0.0038 (0.0014)***	0.0129 (0.0037)***	−0.0062 (0.0024)***
Foreign direct investment inflows	−0.0025 (0.0012)**	−0.0024 (0.0012)**	0.0048 (0.0081)	0.0005 (0.0012)
Trade	−0.0006 (0.0003)*	−0.0007 (0.0003)**	−0.0006 (0.0006)	−0.0014 (0.0006)**
Ores and metals exports	−0.0018 (0.0010)*	−0.0021 (0.0011)*	0.0075 (0.0043)*	−0.0045 (0.0014)***
Fuel exports	−0.0016 (0.0004)***	−0.0020 (0.0005)***	−0.0014 (0.0007)**	−0.0085 (0.0033)***
Gross enrolment ratio, secondary	−0.0040 (0.0008)***			
Gross enrolment ratio, tertiary	−0.0023 (0.0006)***			
Institutional quality	0.0047 (0.0017)***	0.0058 (0.0019)***	0.0045 (0.0030)	0.0004 (0.0046)
Political rights suppression	−0.0301 (0.0139)**	−0.0263 (0.0144)*	−0.0709 (0.0252)***	−0.0295 (0.0364)
Civil liberties suppression	−0.0423 (0.0218)*			
Civil liberties suppression(ST)		−0.0780 (0.0378)**	0.1695 (0.0780)**	−0.5357 (0.1592)***
Gross enrolment ratio, secondary(ST)		−0.0635 (0.0138)***	−0.0340 (0.0416)	−0.1555 (0.1856)
CL* Gross enrolment ratio, secondary		−0.0013 (0.0133)	−0.1435 (0.0493)***	−0.0457 (0.1415)
Gross enrolment ratio, tertiary(ST)		−0.0481 (0.0129)***	−0.2582 (0.0686)***	0.3755 (0.1092)***
CL* Gross enrolment ratio, tertiary		0.0194 (0.0126)	0.2451 (0.0784)***	0.3432 (0.0863)***
Constant	2.5619 (0.2566)***	1.9778 (0.2770)***	1.4853 (0.5484)***	1.2959 (0.6757)*
R^2	0.15	0.15	0.20	0.19
Variance inflation factor	4.22	4.26	5.66	5.32
Time effect	3.72***	3.56***	1.64*	1.23
Sector effects	126.86***	125.57***	106.92***	49.06***
N	35,031	35,031	15,364	19,667

*$p < 0.1$; **$p < 0.05$; ***$p < 0.01$

statistically significant way influences the jobs created. Both political rights and civil liberties suppression have a negative sign, indicating that countries with less democratic regimes and more suppressed civil liberties tend to attract less FDI, as measured by the jobs created. This finding verifies both hypotheses 1 and 2, where we argued that the higher level of political rights and civil liberties suppression will negatively influence FDI.

Our second model presents the interaction effects of civil liberties suppression and human capital. The remaining variables of our model behave exactly the same as our model 1.1, showing the robustness of our specification. Institutional quality still remains positive, and significant and political rights suppression keep their negative and significant sign. The effect of civil liberties suppression remains negative and significant, whilst both indicators of human capital have a negative and statistically significant sign. The two interaction effects have a negative and positive sign for secondary and tertiary education enrolment, but remain insignificant, thus not supporting our third hypothesis that the existence of human capital will positively moderate (enhance) the effect of civil liberties.

In order to shed further light into the lack of support for our third hypothesis, we decided to split our sample into countries with low levels of civil liberties (CL ≥ 4) and high levels of civil liberties (CL < 4).[3] Model 1.3 presents the results for these economies where civil liberties are relatively suppressed. Again, the size of the economy is positive and statistically significant and the cost of labour changes sign and becomes positive and significant. Although this is counterintuitive, it might happen because the wages in these locations are relatively low and a potential increase might actually motivate workers to become more productive and thus attract more FDI. Although institutional quality does not matter anymore (keeps its positive sign, but becomes insignificant), the effect of political rights suppression remains the same, with more liberal economies attracting higher levels of FDI with respect to jobs created. This provides further support to our first hypothesis. On the contrary, civil liberties suppression changes sign and become positive and statistically significant, indicating that for these economies where civil liberties are suppressed, MNEs would increase their FDI commitment in terms of jobs created. The level of gross enrolment in secondary education now

[3] To choose among various breakpoints in our sample, we also employed the Supremum F test, which involves estimating all Chow F-statistics for each potential breakpoint in the sample and choosing the one where the F-statistic was higher. When this test was implemented, the breakpoint was determined at *CL* = 4. The differences of the estimated coefficients among the two models (CL ≤ 4 and *CL* < 4) were not as statistically significant as the ones presented here. Further both R-squares were much lower than when the breakpoint was at *CIVILREP* = 3.

becomes in significant, and the level of gross enrolment in tertiary education remains negative and statistically significant, indicating that MNEs will tend to avoid locations with high suppression of civil liberties and high levels of human capital, especially highly skilled ones. This partially supports our third hypothesis indicating that MNEs will prefer locations of suppressed civil liberties, but only in locations with low levels of human capital. Looking at model 1.4, the results represent countries with relatively high levels of civil liberties (CL < 4). Once more, the size of the economy plays a positive and significant role whilst the labour cost proxy shows a negative and statistically significant sign. In the case of these economies, neither the institutional quality nor the political rights play any role, although both keep their expected signs, positive for institutional quality and negative for political rights suppression. In this case, the effect of civil liberties suppression returns to negative and therefore provides support for our second hypothesis. The impact of human capital as measured by the secondary education enrolment is not statistically significant whilst both the direct effect of tertiary education enrolment and its interaction effect with civil liberties suppression have a positive and statistically significant sign. This, again, partially supports our third hypothesis on the positive (enhancing) moderating effect of the existence of human capital on the impact of civil liberties suppression on FDI as measured by the jobs created.

Conclusion

Given the important role of FDI in enhancing economic growth and development, particularly through creating spill-overs and upgrading the local human capital, this study aims at offering a holistic and coherent answer to the effect that political rights and civil liberties of the host location have on FDI decisions by MNEs. We have argued that political rights' suppression has a direct negative impact on FDI and that non-democratic countries are less likely to attract high levels of FDI. Our empirical investigation supports this argument, in line with our first hypothesis, thus reinforcing the findings of Jensen (2003), Addison and Heshmati (2003), and Adam and Filippaios (2007).

On the other hand, the effect of civil liberties will also be dependent on the existence of human capital in the economy. Our focus was on emerging and developing economies in order to provide evidence on the differential behaviour of MNEs emerging from a number of countries. Our overall results on the effect of civil liberties on FDI are in line with the findings of Asiedu and

Lien (2011), Adam and Filippaios (2007), Li and Resnick (2003) and our theoretical argumentation.

Our study raises a number of research avenues. First, we could look at differential effect of political rights and civil liberties suppression on investors from different home countries, given that there could be a difference between the behaviour of investors originating from developed and developing economies. Second, we could look at the differential effect of political rights and civil liberties suppression for different industries, and possibly test the hypothesis that the effects could be stronger for labour intensive industries. Our current study does not address these two dimensions as we aimed to provide a more general perspective.

Future research on the effect of civil liberties and political rights on FDI could use sub-indicators (sub-categories) of civil liberties and political rights to further examine their effect on FDI activity. This would help clarify how various aspects of these concepts influence FDI activity. Furthermore, although this research has controlled for the effects of time and industries, a closer examination of the way firms from various economies coordinate their activities and allocate their FDI would shed further light on the existence of a home market effect.

Appendix 1: List of recipient countries

Albania; Algeria; Angola; Argentina; Armenia; Azerbaijan; Bahamas; Bahrain; Bangladesh; Belarus; Bolivia; Botswana; Brazil; Bulgaria; Burkina Faso; Cameroon; Chile; China; Colombia; Congo (DRC); Costa Rica; Cote d'Ivoire (Ivory Coast); Croatia; Cuba; Czech Republic; Dominican Republic; Ecuador; Egypt; El Salvador; Estonia; Ethiopia; Gabon; Gambia; Ghana; Guatemala; Guinea; Guinea-Bissau; Guyana; Haiti; Honduras; Hungary; India; Indonesia; Iran; Iraq; Jamaica; Jordan; Kazakhstan; Kenya; Kuwait; Latvia; Lebanon; Liberia; Libya; Lithuania; Madagascar; Malawi; Malaysia; Mali; Malta; Mexico; Moldova; Mongolia; Morocco; Mozambique; Myanmar (Burma); Namibia; Nicaragua; Niger; Nigeria; North Korea; Oman; Pakistan; Panama; Papua; New Guinea; Paraguay; Peru; Philippines; Poland; Qatar; Republic of the Congo; Romania; Russia; Saudi Arabia; Senegal; Serbia; Sierra Leone; Slovakia; Slovenia; Somalia; South Africa; South Korea; Sri Lanka; Sudan; Suriname; Tanzania; Thailand; Togo; Trinidad & Tobago; Tunisia; Turkey; UAE; Uganda; Ukraine; Uruguay; Venezuela; Vietnam; Yemen; Zambia; Zimbabwe.

Appendix 2: Correlation matrix

	Jobs created	GDP	GDP per person employed	FDI Inflows	Trade	Ores and metals exports	Fuel exports	Gross enrol-ment ratio, secondary	Gross enrol-ment ratio, tertiary	Institu-tional quality	Political rights	Civil liberties
Jobs created	1.0000											
GDP	0.0645	1.0000										
GDP per person employed	−0.0751	−0.4267	1.0000									
FDI Inflows	−0.0208	−0.2743	0.0871	1.0000								
Trade	−0.0549	−0.6103	0.4642	0.2823	1.0000							
Ores and metals exports	−0.0218	−0.2395	0.1045	0.1301	−0.0654	1.0000						
Fuel exports	−0.0615	−0.1133	0.0384	−0.0206	−0.0976	−0.0116	1.0000					
Gross enrolment ratio, secondary	−0.0816	−0.3679	0.6926	0.1440	0.3365	−0.0005	0.1174	1.0000				
Gross enrolment ratio, tertiary	−0.0633	−0.4155	0.6986	0.1163	0.3810	0.0922	0.1323	0.7241	1.0000			
Institutional quality	−0.0027	−0.3881	0.5671	0.2235	0.4788	0.0751	−0.1733	0.4696	0.4159	1.0000		
Political rights suppression	−0.0327	0.5437	−0.3172	−0.0854	−0.2607	−0.2415	0.1634	−0.1726	−0.3070	−0.3398	1.0000	
Civil liberties suppression	−0.0185	0.6402	−0.4124	−0.1438	−0.3736	−0.2548	0.1975	−0.2967	−0.4360	−0.4483	0.9573	1.0000

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13

Pay Dispersion, Culture and Bank Performance

Ellen Pei-yi Yu and Bac Van Luu

Introduction

There has been a long-standing debate in the executive compensation literature as to whether higher or lower pay dispersion can enhance organizational performance. In sport, previous studies obtain supporting evidence for the tournament theory and suggest that golfers' performance improves as prized differentials increase. For professional racing drivers, pay dispersion also has a positive impact on both individual performance and driver safety. On the other hand, a baseball game relies on individual efforts as well as cooperation between team members and is said to benefit from greater equity in pay.

However, the issue of pay dispersion has not received much attention in the banking literature, and the main contribution of our study is to fill this gap using a study with global scope. In particular, we look at pay dispersion at the top executive level and test whether the tournament theory or the equity fairness theory is applicable to bank performance. The need for such research has gained in importance and urgency recently as compensation issues have figured quite prominently in larger discussions concerning the relationship between the effective corporate governance and bank performance. Moreover, policymakers care about the design of executive pay at banks because the

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systemic importance of banks and the use of taxpayer money to rescue failing institutions distinguish them from non-financial corporations.

Since we use international data to examine the extent to which executive pay dispersion affects bank performance and valuation, we wonder how this relationship could be affected by institutional, legal and other relevant structural differences across countries. One contribution of our study is to incorporate the notion that cultural factors may have an impact on how pay dispersion influences firm performance and valuation. For example, the dysfunctional effect of pay dispersion on team performance may be stronger in cultures that are characterized as more collectivist.

The remainder of this chapter is organized as follows. In "Literature Review", we review the literature streams on pay dispersion and cultural differences in finance research. In the section "Theoretical Model", we describe our theoretical model. In the section "Data and Empirical Results", we report the empirical results. We summarize and conclude in the section "Conclusion".

Literature Review

Tournament vs. Equity Fairness Theory

Prior research on compensation and performance first investigated chief executive pay, then expanding the scope to the compensation of the entire managerial team. For example, Barron and Waddell (2003) found that higher-rank managers have a greater proportion of incentive-based compensation in pay packages than do lower-ranked executives. Overall, the early literature into executive compensation has primarily focused on issues related to the level and structural mix of compensation packages, and their sensitivity to firm performance (e.g. Kale et al. 2009; Aggarwal and Samwick 1999). However, studies on the impact of executive compensation in the financial and banking sector are scarce. One exception is Becht et al. (2011), who suggest that more shareholder power can lead to more risk taking; therefore, equity-based incentives for executives can lead to excessive risk taking. The tournament theory (Grund and Westergaard-Nielsen 2008; Kale et al. 2009) predicts that compensation across managers will be more dispersed than that under the equity fairness theory. The tournament theory is also known as the hierarchical pay hypothesis in the literature. It was first developed by Lazear and Rosen (1981), who contend that compensation spreads are not based on marginal productivity, but rather on relative differences between the individuals. In the presence of a tight positive relationship between employee effort and output, efficiency can be secured by the widening of pay dispersion across the corporate hierarchy toward top positions. Good examples of the applicability of the tournament theory can be found in professional sports.

The equity fairness theory (Wade et al. 2006) indicates that large pay dispersion can increase envy and dysfunctional behaviour among team members. This may give rise to negative effects of pay disparity on firm performance. According to Lazear (1989), wage dispersion affects not only the final team output but also the way this output is produced. Members of high-inequality teams behave less cooperatively and act more selfishly than members of teams with a compressed wage structure.

Comparative studies are relatively rare. Beaumont and Harris (2003) investigate whether a hierarchical or compressed wage structure has a positive impact on organizational performance by employing UK manufacturing micro-data in five industrial sectors.

Cultural Differences

We include Hofstede's (1980, 2001) cultural dimensions as control variables when exploring the impact of pay dispersion on bank performance. While the inclusion of cultural dimensions is common in the business and management literature, cultural variables have only recently gained acceptance in the finance literature (Aggarwal and Goodell 2014). In an early contribution to the literature, Stulz and Williamson (2003) find that cultural variations, proxied by differences in religion and language, can help to explain how investor protection diverges across countries. Aggarwal et al. (2012) incorporate Hofstede's cultural variables in gravity models of foreign portfolio investment. Studies on the impact of culture on asset prices have emerged, following the research by Chui et al. (2010), who detect a significant relationship between the cultural dimension of individualism and stock market momentum. Beugelsdijk and Frijns (2010) examine the influence of culture and cultural distance on international asset allocation. Anderson et al. (2011) also investigate the effect of culture on international diversification in institutionally managed portfolios. These studies suggest that culture may be an important omitted variable in cross-country asset pricing studies. Research on the impact of culture on pay has been even rarer and, to our knowledge, our study is the first to examine the influence of culture and pay dispersion on performance and valuation of banks.

Theoretical Model

Since theory does not provide strong arguments in favor of the equity fairness or the tournament theory, the nature of the relationship between executive pay dispersion and bank performance remains an empirical question. Our theoretical model has been inspired by the following two studies: (1) a translog profit function introduced by Mullineaux (1978), which is used to estimate economies of scale and efficiency; and (2) a pay dispersion model proposed by Franck and Nüesch (2011), which focuses on the impact of intra-team pay dispersion on German soccer team productivity. By modifying and combining these two models, we are able to address the potential problems of relying on reduced-form estimation.

Modeling Bank Performance

In our opinion, the unique nature of the banking industry, that is, the combination of labour, interest and capital to produce banking services, is captured more fully by incorporating the characteristics of the translog profit function rather than by a reduced-form model. One of the most widely used flexible functional forms for a profit function is the transcendental logarithmic function form since this form is easily adaptable to include multiple banking outputs and multiple banking inputs. A typical full translog profit function (Mullineaux 1978) in "output prices", "prices of variable inputs" and "quantities of the fixed factors" can be expressed as follows:

$$
\begin{aligned}
\ln \mathit{profit} &= a_0 + \sum_{i=1}^{m} a_i \ln(\mathit{output}_i) + \sum_{j=1}^{n} b_j \ln(\mathit{input}_j) + \sum_{k=1}^{p} c_k \ln(\mathit{fixedfactor}_k) \\
&+ \frac{1}{2}[\sum_{i=1}^{m}\sum_{k=1}^{m} g_{jk} \ln(\mathit{output}_i)\ln(\mathit{output}_k) + \sum_{j=1}^{n}\sum_{k=1}^{n} h_{jk} \ln(\mathit{input}_j)\ln(\mathit{input}_k) \\
&+ \sum_{k=1}^{j=p}\sum_{j=1}^{p} l_{kj} \ln(\mathit{fixedfactor}_k)\ln(\mathit{fixedfactor}_j)] + \sum_{i=1}^{m}\sum_{j=1}^{n} q_{ij} \ln(\mathit{output}_i)\ln(\mathit{input}_j) \\
&+ \sum_{i=1}^{m}\sum_{k=1}^{p} r_{jk} \ln(\mathit{output}_i)\ln(\mathit{fixedfactor}_k) + \sum_{j=1}^{n}\sum_{k=1}^{p} s_{jk} \ln(\mathit{input}_j)\ln(\mathit{fixedfactor}_k),
\end{aligned}
\tag{1}
$$

where *profit* is defined as total revenue minus the cost of the variable factors of production; *output* are the m bank output prices; *input* are the prices of the n variable inputs; and *fixedfactor* are the P quantities of the fixed factors of production.

The theory of the translog profit function provides us with a solid background to explain why output prices, prices of variable inputs and quantities of fixed factors can serve as control variables for our model of executive pay dispersion and bank performance.

Modeling Pay Dispersion

The existing literature largely concentrates on linear effects (Hibbs and Locking 2000), while Grund and Westergaard-Nielsen (2008) and Franck and Nüesch (2011) propose that the relationship between intra-team wage differentials and team performance is less likely to be linear under the two competing paradigms discussed earlier—the tournament theory and the equity fairness theory. To allow for potential non-linearity in our study, we include a linear term of *paydisp* and the quadratic term $paydisp^2$ into our theoretical model. Since Franck and Nüesch (2011) indicate that the Gini coefficient and the coefficient of variation (CV) are strongly correlated, we adopt the CV of total compensation as our only indicator of the variable of pay dispersion in this study. The CV is a normalized measure of dispersion of a probability distribution and is computed as the ratio of the standard deviation to the mean.

Combined Model and Variable Definitions

Our main model is in equation (2), which is based on the combination of a pay dispersion model and a modified translog profit function applied to the banking industry. In addition to our original performance indicator, the variable of "Profit", we also investigate two further performance measures that relate to the market's valuation of banks, the "Tobin's Q" and "Price-to-Book" (P/B) ratios. If compensation includes stock options, executives may target market valuations and share prices rather than operational performance measures such as profit. In equation (2), we also control for the impact from different bank regulatory systems, capital adequacy and corporate governance variables, while we investigate the relationship between the variable of pay dispersion at the top executive level and our indicators of bank performance. Overall, there are four categories of variables in our major equation: (a) banking firms' performance indicators, (b) banking firms' inputs, (c) banking firms' outputs and (d) control variables with regard to the different regulatory systems, capital adequacy and corporate governance.

$$
\begin{aligned}
&performance_{it} = a_0 + r\left(paydisp_{it}\right) + s\left(paydisp_{it}\right)^2 + a\ln\left(output_{it}\right) + \\
&\sum_{j=1}^{n} b_j \ln\left(input_{jit}\right) + c\ln\left(fixedfactor_{it}\right) \\
&+\frac{1}{2}\left[\begin{array}{l} g\ln\left(output_{it}\right)\ln\left(output_{it}\right) + \sum_{j=1}^{n}\sum_{k=1}^{n} h_{jk}\ln\left(input_{jit}\right)\ln\left(input_{kit}\right) + \\ l\ln\left(fixedfactor_{it}\right)\ln\left(fixedfactor_{it}\right) \end{array}\right] \\
&+\sum_{j=1}^{n} q_j \ln\left(output_{it}\right)\ln\left(input_{jit}\right) + r\ln\left(output_{it}\right)\ln\left(fixedfactor_{it}\right) + \\
&\sum_{j=1}^{n} s_j \ln\left(input_{jit}\right)\ln\left(fixedfactor_{it}\right) \\
&+\sum_{j=1}^{n} m_j \left(control_{jit}\right),
\end{aligned}
\tag{2}
$$

where the control variables $control_j$ are the dummy variables for widely owned and CEO duality, capital adequacy, default risk and development status, respectively.

Bank Performance Indicators

Undoubtedly, bank profit should be chosen as one of our performance indicators. However, more than one proxy for bank performance was adopted since we would also like to examine whether pay dispersion is reflected in the way that the stock market values banks. Therefore, the profit indicator is employed as the measure representing operational performance, while the Tobin's Q and P/B ratios (Caprio et al. 2007) are also adopted as indicators of the market valuation of our sample banks.

Banking Firms' Inputs

For estimating the prices of banking firms' inputs, we include the interest price and the labour price as two input variables, which are also commonly viewed as key inputs in the banking literature on the translog profit function and translog cost function (Yu and Van Luu 2003).

Banking Firms' Outputs

We consider that the modern banking industry has more diversified businesses than simply operating in the traditional banking loan business. In contrast to previous studies in banking (Berger et al. 1993), which mainly use loan rates, we define the variable of output as the sum of interest income and investment income divided by total earning assets.

Other Control Variables

(1) *Corporate governance variables*

In our view, corporate governance structures are likely to affect the association between firm performance and pay dispersion. We therefore include the following two variables: "controlling ownership" and "CEO duality".

- Controlling ownership:
- We classify a bank as having a controlling owner if the shareholder has voting rights that sum to 10% or more; otherwise, we classify the banks as widely held. In the previous research, it was argued that 10% voting rights are frequently sufficient to exert control (La Porta et al. 2002; Yu and Van Luu 2016). We observe in our sub-sample of banks from Developing Countries that banks are not generally widely held.
- CEO duality:
- We include this variable into our major equation for examining whether the combined roles of the CEO and board chairman in the same person could affect the association between firm performance and pay dispersion.

(2) *Size*

In order to control for additional bank-specific characteristics, we include the logarithm of each bank's total assets as the indicator of the size factor since "bank size" may influence valuations (Caprio et al. 2007; Yu and Van Luu 2003). The size of the bank has been adopted as our fixed factor. The quantity of fixed inputs cannot be changed during the production period.

(3) *Capital Adequacy*
Tier 1 capital is included in our model as one of our control variables to control for the impact of different regulatory restrictions on banks. Although most countries have indicated their intention to adopt the much more detailed set of recommendations contained in Basel II and III, not all of our sample countries adopted the Basel Committee's original recommendations on capital regulations and official supervision. Differences in Tier 1 capital ratios across these sample banks may also be a reflection of differences in regulatory restrictions on banks across countries.

(4) *Legal origins*
Many studies investigate effects of law and regulations for corporations. In order to investigate the impact of different regulatory systems, we classify our sub-sample banks from developed Organisation for Economic Co-operation and Development (OECD) countries according to the origin of their legal systems into Common Law and Civil Law countries.

Cultural Dimensions

Some theories of pay determination such as, for example, the efficiency wage theory, postulate that compensation is not driven only by economic motives, and that notions of fairness can have a bearing on organizational behaviour. It is a natural extension of this idea to ask whether cultural divergences have a bearing on how pay and pay dispersion impact on firm performance. According to Hofstede (2010), "culture" is like the collective programming of the mind distinguishing the members of one group of people from others. The values that distinguish country cultures from each other can be statistically categorized into four groups, which we use to control for the cross-country cultural differences between the 20 countries in our sample.[1] These four dimensions are (a) Power Distance (PDI), (b) Individualism (IDV), (c) Masculinity (MAS) and (d) Uncertainty Avoidance (UAI). The values range from 0 to 100.

[1] The measurement of culture is based on comprehensive studies by Hofstede on how values in the workplace are influenced by culture among IBM employees, starting in the late 1960s. Subsequent studies validating the earlier results include such respondent groups as commercial airline pilots and students in 23 countries, civil service managers in 14 counties, "'up-market" consumers in 15 countries and "'elites" in 19 countries. In the 2010 edition of the book *Cultures and Organizations: Software of the Mind*, scores on the dimensions are listed for 76 countries, partly based on replications and extensions of the IBM study on different international populations and by different scholars. We use these values for our study.

The dimension of Power Distance measures the degree to which the less powerful members of a society accept the fact that power is distributed unequally. Inhabitants of countries with high values of power distance accept a hierarchical order in which individuals have their place and they do not need further justification for this hierarchy. In societies with low power distance, people aim to equalize the distribution of power and demand rationalization for inequalities of power. Individualism quantifies the degree of interdependence a society maintains among its members. In highly individualist societies, people look after themselves and their immediate family only, whereas in collectivist societies people belong to larger groups that take care of them in exchange for loyalty. A high value on the Masculinity dimension indicates that a society values competition, achievement and success. A low score on the dimension (describing a society which is characterized as feminine) suggests that compassion for others and the quality of life are more important than winning and standing out. Finally, Uncertainty Avoidance appraises the way that a society deals with the ambiguities of an uncertain future. In countries with a high score for uncertainty avoidance, people feel threatened by uncertainty and have created mechanisms for avoiding these ambiguous or unknown situations.

Data and Empirical Results

In this section, we report and interpret our empirical results.

Data Sources

The greatest challenge, and one of the contributions of this study, is to generate the data of executive pay dispersion for 92 sample banks worldwide. The sample banks from our first sub-group have been chosen from the top 500 OECD banks by asset size. Banks were included in the study only if their relevant executive remuneration data were available from annual reports or Thomson One databases to enable us to generate the executive pay dispersion data for each sample bank. Finally, based on the annual compensation dataset, we generate the pay dispersion variable for each sample bank in each sample year by computing the mean and standard deviation of the compensation of the top three to five executives. We use actual compensation to determine pay dispersion, and we define "the total annual compensation" for each managerial team member as the total cash value of all pay components in that sample year, including salary, cash bonus, equity options and other compensations. Table 13.1 reports the average executive pay dispersion for each of our sub-sample banks. We compute the mean and standard deviation of the compensation of the top three to five executives in each of our sample banks. Our mean dispersion (CV) of management compensation is 0.3977 with an interquartile range of 0.2839, suggesting considerable smaller sample cross-sectional variability of pay dispersion compared with the previous literature. We find that the estimated average executive pay dispersions in Common Law and Civil Law are significantly higher than those in Developing Countries. Moreover, among our five groups, banks from Common Law countries have the highest average executive pay dispersion.

We summarize our estimation methods for each variable and their definition in Table 13.2.

Table 13.3 presents the descriptive statistics of all variables in this study.

Table 13.4 lists the scores on the four different cultural dimensions for each sub-sample group.

Econometric Procedure

We analyze our unbalanced panel data by employing the following econometric procedure. Firstly, we examine our data using the likelihood ratio test. The null hypothesis of the likelihood ratio test is that the intercepts are the same for each bank and for each year. Secondly, we employ the Hausman test to decide whether the fixed effects model or random effects model suits our panel data better. For the fixed effects model, it is possible to allow for both entity-fixed effects and time-fixed effects within the same model. The random effects could be along either the cross-sectional or period dimensions. However, since we have missing data in our dataset, we cannot have time variation and cross-section variation at the same time when the random effects model is employed in our study.

Table 13.1 Executive pay dispersion of our five groups of countries

Our sub-sample banks	Worldwide 92 banks	Developed 63 banks	Developing 29 banks	Common Law 27 banks	Civil Law 36 banks
Executive pay dispersion	0.3977 (0.2839)	0.4673 (0.2723)	0.2515 (0.2509)	0.5016 (0.2440)	0.4274 (0.2978)

Table 13.2 Definitions of variables in our model and their estimation methods

Variable	Definition
Pay dispersion indicators	
(paydisp)	In this study, we adopt the coefficient of variation (CV) as the indicator of the pay dispersion.
$(\text{paydisp})^2$	The CV squared has also been included.
Banking firms' performance indicators	
Total profit	The variable of **profit** is defined as total revenue minus the cost of the variable factors of production.
Pre-tax profit margin	Pre-tax profit margin = [Pretax Income (Losses)]/(Net Revenue)]
Return on Equity (ROE)	ROE = (net income available for common shareholders)/(average total common equity)
Tobin Q	Tobin Q = (market capitalization + liabilities + preferred equity + minority interest)/(total assets)
P/B ratio	P/B ratio = (share price)/(book value per share)
Output prices	
Output	Output = (interest income)/(earning assets) More precise definition of our "Output" is as follows: Output = [(interest income) + (investment income)]/[(marketable securities) + (short-term securities) + (total loans) + (interbank assets) + (long-term investments and long-term receivables)]
Input prices	
Labour price	In this study, we define the factor of labour price as the average wage rate of bank officers. Labour input price = (personnel expense)/(number of employees)
Interest input price	Interest price = (interest expense)/(average interest bearing liabilities)
Quantities of fixed factors	
Bank size	The logarithm of each bank's total assets
Control variables	
Corporate governance factors	**Widely owned** We define controlling ownership as being present when a shareholder owns more than 10%, otherwise the bank is widely owned. widely owned = 1, otherwise controlling ownership is present, not widely owned = 0 **CEO duality** In this study, we assume that if CEO and Chairman are different = 1, otherwise the same = 0.
Capital adequacy	Tier 1 capital ratio = Tier 1 capital/risk-weighted assets.
Default risk	Default risk = (Non-performing asset)/(total assets)
Dummy variable for development status	A group for Developed Countries = 1 A group for Developing Countries = 0

Table 13.3 Descriptive statistics of all variables (Currency: US dollar)

	Abbreviation of variable	Mean	Median	Maximum	Minimum	Standard deviation
Bank asset size (measurement unit: million US dollars)	Size	597,572.2	290,816.7	3,649,800	4136.773	724,035.3
Pre-tax profit	Profit	4718.660	2200.030	48,923.34	13.23800	6431.091
Interest price (%)	Interest	4.087504	3.689700	20.33500	0.589900	2.141603
Default risk (%)	Defaultr	1.912710	0.886850	34.82890	0.000000	3.186683
Output	Output	0.048843	0.044700	0.192053	0.007140	0.020660
Capital adequacy—Tier 1 capital ratio (%)	Tier1	9.855876	9.310000	32.00000	−1.470000	3.118807
Labour price	Labourp	0.084283	0.073436	0.504750	0.005875	0.072025
ROE	Roe	11.88407	14.12185	42.32480	−156.5255	14.27658
Pretax profit margin (%)	pretaxmargin	22.11411	28.11740	85.26910	−535.5368	40.55895
Tobin Q	Tobinq	1.030052	1.017750	1.619800	0.941800	0.061815
P/B ratio	Pb	1.549660	1.333900	8.127300	0.024800	1.065410
Pay dispersion	Paydisp	0.397701	0.345394	1.459283	0.000000	0.283854

Table 13.4 Pay Dispersion vs. Culture Dimensions for our five sub-sample banks

Our sub-sample banks	Worldwide 92 banks	Developed 63 banks	Developing 29 banks	Common Law 27 banks	Civil Law 36 banks
Individualism vs. Collectivism (Hofstede's Individualism index; score)	61.6413 (23.9453)	75.0318 (13.3617)	32.5517 (13.9516)	84.9259 (8.4454)	67.6111 (11.4250)
Power Distance (Hofstede's Power Distance index; score)	54.1630 (19.7682)	42.8889 (12.8845)	78.6552 (1.4948)	37.4444 (2.8647)	46.9722 (15.6758)
Masculinity versus Femininity (Hofstede's Masculinity index; score)	55.1413 (16.6106)	52.2064 (19.0883)	61.5172 (4.9827)	60.0741 (5.6417)	49.5278 (21.8058)
Uncertainty Avoidance Index (Hofstede's Uncertainty Avoidance index; score)	52.5109 (19.8781)	60.8095 (18.6302)	34.4828 (4.9827)	45.5926 (5.3322)	72.2222 (16.7942)

Discussion of Results

We analyze our unbalanced panel data by employing the same econometric procedures described above for each of our sub-samples. After estimating the pay dispersion model represented in equation (2), we carry out Wald tests on both coefficients of the linear and the quadratic term of the variable of executive pay dispersion. We start by pooling all of our sample banks, but do not report the results because the diagnostic results suggest that doing so does not produce an adequate model. We find that the residuals of these global regressions are not normally distributed, even after adding cultural variables to equation (5) in order to control for the cross-country difference. Therefore, it is not appropriate to pool all of our sample banks.

Instead, we further divide our sample into four smaller sub-samples: Developing (29 banks in developing countries); Developed (63 banks in developed countries); Civil Law countries (36 banks) and Common Law countries banks (27 banks)—see Appendix (Table 13.11).

We start by discussing the results for banks in the Developed Country sub-sample using Tobin's Q (Table 13.5) and P/B (Table 13.6) as dependent variables. We obtain reasonable adjusted R^2 for these regressions ranging from 76.61% to 78.19%. All of the residual distributions of these regressions for the three performance indicators are also normal, although the linear term and the quadratic terms of pay dispersion are only statistically significant for the two indicators of market valuation, the P/B ratio and the Tobin's Q ratio, but not the log(Profit) variable. The coefficients of the pay dispersion variables are consistent across the cultural control variables used, that is, negative for the linear and positive for the quadratic term. Both sets of empirical results for Tobin's Q and the P/B ratio can be interpreted as supporting evidence of equity fairness, except for very high pay dispersion (U-shaped impact curve). The U-shaped relationship between the variable of pay dispersion and these two indicators of market valuation is depicted in Figs. 13.1 and 13.2. For most values of pay dispersion, the impact is negative, supporting the equity fairness theory, although the tournament theory is corroborated for extremely high pay dispersion. With regard to the cultural variables, we find that two of the four cultural dimensions have a significant effect on the performance indicators. Individualism is positively associated with P/B and Tobin's Q while Uncertainty Avoidance has a negative relationship with the market valuation indicators.

To study whether the institutional and legal structure of Developed Countries has a bearing on the impact of pay dispersion on bank performance, we divide our sub-sample into two smaller groups: a group of Civil Law coun-

Table 13.5 Analyses on Tobin's Q—"a group of Developed Countries banks (63 banks)"

Performance indicators	Tobin Q				
		Individualism	Power Distance	Masculinity	Uncertainty Avoidance
C			0.7883* (0.4001)	0.7745* (0.4044)	1.0238*** (0.3646)
Pay dispersion	−0.0690** (0.0290)	−0.0903*** (0.0280)	−0.0674** (0.0294)	−0.0069** (0.0290)	−0.0712** (0.0281)
(Pay dispersion)^2	0.0630*** (0.0213)	0.0752*** (0.0217)	0.0615*** (0.0217)	0.0630*** (0.0212)	0.0619*** (0.0213)
Cultural Index		Individualism 0.0007*** (0.0002)	Power Distance −7.45E−05 (0.0002)	Masculinity −6.10E−05 (0.000162	Uncertainty Avoidance −−0.0003*** (9.74E−05)
log(output)					
log(interestp/100)					
log(labourp)					
log(size)					
0.5*log(output)*log(output)					
0.5*log(interestp/100)*log(interestp/100)					
0.5*log(labourp)*log(labourp)					
0.5*log(size)*log(size)					
log(output)*log(interestp/100)		−0.0317** (0.0159)			
log(output)*log(labourp)					
log(output)*log(size)					
log(interestp/100)*log(labourp)	0.0329** (0.0153)	0.0314** (0.0135)	0.0317** (0.0157)	0.0342** (0.0157)	0.0304** (0.0147)
log(interestp/100)*log(size)					
log(labourp)*log(size)					
Widely owned	0.0131*** (0.0044)	0.0097** (0.0041)	0.0133*** (0.0044)	0.0130*** (0.0044)	0.0123*** (0.0042)
(defaultr/100)	−0.7318*** (0.1899)	−0.6692*** (0.1597)	−0.7389*** (0.1942)	−0.7377*** (0.1866)	−0.7348*** (0.1706)
(tier1/100)			0.2379* (0.1414)		
Adjusted R^2	0.7998	0.8125	0.7969	0.8004	0.8057

tries and a group of Common Law countries. We observe that the average pay dispersion of the sub-sample of Common Law countries is 0.5016, which is slightly higher than the average pay dispersion of the sub-sample of Civil Law country at 0.4274 (Table 13.1).

Table 13.6 Analyses on the P/B ratio—"a group of Developed Countries banks (63 banks)"

Performance indicators	P/B ratio				
		Individualism	Power Distance	Masculinity	Uncertainty Avoidance
C				−25.3483	
				(11.4150)	
Pay dispersion	−0.9698*	−1.1131*	−0.2312	−0.6505	−0.5080
	(0.5291)	(0.5982)	(0.6362)	(0.6455)	(0.6048)
(Pay dispersion)^2	0.8760**	0.9342**	0.3438	0.6750	0.5054
	(0.3821)	(0.4601)	(0.5068)	(0.5276)	(0.4662)
Cultural Index		Individualism	Power Distance	Masculinity	Uncertainty Avoidance
		0.0202***	−−0.0117***	0.0099*	−−0.0115***
		(0.0045)	(0.0039)	(0.0050)	(0.0029)
log(output)					
log(interestp/100)					
log(labourp)					
log(size)		3.2398***	2.9391***	4.4287***	2.6675**
		(1.0881)	(1.1071)	(1.2149)	(1.1118)
0.5*log(output)*log(output)					
0.5*log(interestp/100)*log(interestp/100)					
0.5*log(labourp)*log(labourp)	1.1717**	1.7250***	1.3285**	1.2507**	1.5605***
	(0.5180)	(0.5102)	(0.6327)	(0.6208)	(0.5932)
0.5*log(size)*log(size)	−0.0929*	−0.1892***	−0.1848**	−0.2702***	−0.1625**
	(0.0555)	(0.0711)	(0.0740)	(0.0826)	(0.0734)
log(output)*log(interestp/100)					
log(output)*log(labourp)					
log(output)*log(size)					
log(interestp/100)*log(labourp)					
log(interestp/100)*log(size)					

(continued)

Table 13.6 (continued)

Performance indicators	P/B ratio				
log(labourp)*log(size)		0.4670**		0.4830*	
		(0.1891)		(0.2048)	
Widely owned	0.2149***				
	(0.0760)				
(defaultr/100)	−11.8308***	−15.0125***	−18.0724***	−15.9818***	−16.8424***
	(2.3645)	(2.6800)	(3.7633)	(4.0637)	(2.8629)
(tier1/100)		−11.5952***	−10.0559***	−10.5769***	−10.6607***
		(2.7397)	(2.7705)	(2.8532)	(2.6761)
Adjusted R^2	0.7819	0.8383	0.6185	0.5754	0.6407

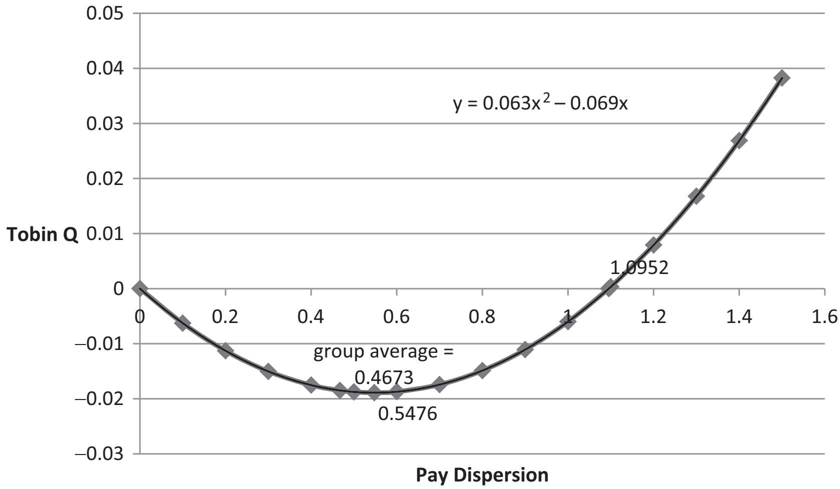

Fig. 13.1 Developed Country banks' Tobin's Q

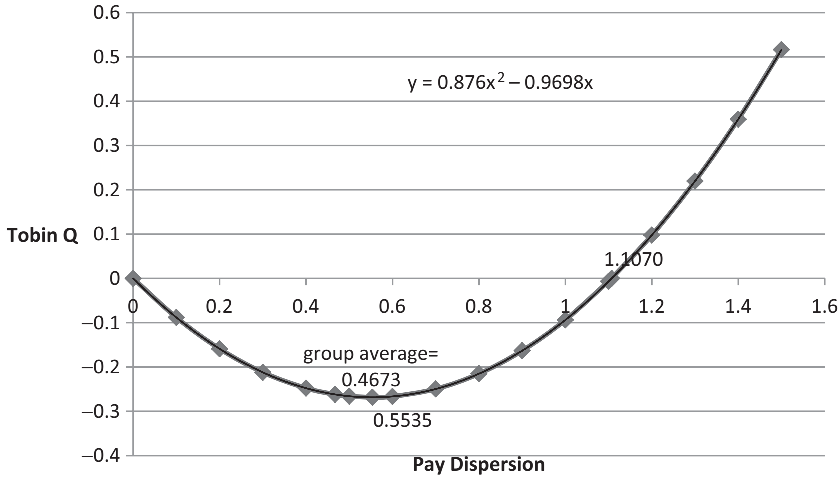

Fig. 13.2 Developed Country banks' P/B ratio

We first discuss banks from Civil Law countries. Although the regression residuals for the indicator of log (profit) are not normally distributed, they are normal for the two indicators of market valuation, the P/B and Tobin's Q ratios, with adjusted R^2 ranging from 85.35% to 90.45%, that is, our model is well specified. The linear term and the quadratic terms of pay dispersion are statistically significant only for the two market valuation indicators. The results for the Tobin's Q ratio and the P/B ratio are consistent, so we only report the empirical results for the P/B ratio in Table 13.7. Our overall results can be interpreted as supporting evidence of equity fairness, except for very high pay dispersion (U-shaped impact curve). We visualize the relationship between the variable of pay dispersion and the P/B ratio in Fig. 13.3. The results for the Tobin's Q ratio and the P/B ratio are consistent and can be interpreted as supporting evidence of equity fairness, except for very high pay dispersion (U-shaped impact curve). Like for Developed Countries overall, very high pay dispersion is beneficial to bank performance in Civil Law countries. However, on average, pay dispersion in this group is 0.4274 and on the left-hand side of the U-shaped curve. This lends support to the equity fairness theory for most observed values of pay dispersion. However, we do not obtain consistent empirical results with regard to the impact of the cultural variables on bank performance and valuation.

The effect of pay dispersion on market valuation is also economically significant. As an illustrative example, we compute the impact of a one-standard deviation change of pay dispersion from the mean on P/B for the sample banks in the group of Civil Law countries. The mean of executive pay dispersion in that group of banks is 0.4274, and the standard deviation is 0.2978 (see Table 13.1). Table 13.5 reports both the linear and quadratic terms of the executive pay dispersion as statistically significant for the P/B ratio; hence, the relationship can be written as $y = \alpha + \beta x + \gamma x^2$, where y denotes P/B, x pay dispersion and α and β the regression coefficients on the linear and quadratic terms. Using the empirical result without controlling for cultural differences, the marginal impact of a one-standard deviation increases in pay dispersion on P/B is calculated as $\frac{\partial y}{\partial x} \times \sigma_x = (\beta + 2\gamma x)\sigma_x$. Evaluated at the mean of pay dispersion μ_x this gives (−1.8034 + 2*1.2663*0.4274) * 0.2987 = −0.2147. Since the mean of the P/B ratio in this sub-sample is 1.0654, the P/B change is 20.15% of the mean. Hence, a one-standard deviation increases in pay dispersion lowers the P/B ratio by around 20%, all else being equal, which is an economically significant effect.

Finally, the empirical results of the group of Common Law are reported in Table 13.8. We obtain good values for adjusted R^2 which range from 82.79% to 85.87%, while the residuals for all of the regressions are normally distributed as well. We find that the linear and quadratic terms of pay dispersion have no impact on the three bank performance indicators. Based on our empirical findings, we conclude that neither the tournament theory nor the equity fairness theory is applicable to the relationship between executive pay dispersion and banks' performance in Common Law countries. None of the cultural dimensions has a statistically significant impact on bank performance.

Table 13.7 Analyses on the P/B ratio—"a group of Civil Law countries banks (36 banks)"

Performance indicators	P/B ratio				
		Individualism	Power Distance	Masculinity	Uncertainty Avoidance
C					
Pay dispersion	−1.8034***	−0.9562	−1.4941***	−1.6009***	−1.5375***
	(0.5147)	(0.6827)	(0.4815)	(0.4651)	(0.4852)
(Pay dispersion)^2	1.2663***	0.5452	1.0507***	1.1351***	1.0821***
	(0.4068)	(0.4979)	(0.3864)	(0.3749)	(0.3857)
Cultural Index		Individualism	Power Distance	Masculinity	Uncertainty Avoidance
		0.0211**	−0.0071**	0.0114***	−0.0081*
		(0.0100)	(0.0033)	(0.0036)	(0.0047)
log(output)					
log(interestp/100)					
log(labourp)					
log(size)		3.3468*			
		(1.7057)			
0.5*log(output)*log(output)	2.5187*	4.0068**		2.2762*	2.5862**
	(1.2754)	(1.7230)		(1.1539)	(1.2833)
0.5*log(interestp/100)*log(interestp/100)					
0.5*log(labourp)*log(labourp)	1.6115***	1.9941***	1.3937***	1.1839***	1.4758***
	(0.4644)	(0.6331)	(0.4821)	(0.4366)	(0.4656)
0.5*log(size)*log(size)					
log(output)*log(interestp/100)		−2.4415**			
		(1.0949)			
log(output)*log(labourp)				1.4087*	
				(0.8288)	
log(output)*log(size)		0.3898*			
		(0.1995)			

(*continued*)

Table 13.7 (continued)

Performance indicators	P/B ratio				
log(interestp/100)*log(labourp)					
log(interestp/100)*log(size)		−0.3295***			
		(0.1232)			
log(labourp)*log(size)		0.6182**		0.4602**	
		(0.2813)		(0.2077)	
Widely owned	0.1276*		0.2246**	0.2583***	0.1829**
	(0.0735)		(0.0907)	(0.0891)	(0.0826)
(defaultr/100)	−6.9496*	−23.3533***	−10.1148**	−12.9223***	−9.1994**
	(3.7985)	(4.5766)	(4.1821)	(4.0730)	(3.8618)
(tier1/100)		−13.0748***			
		(3.7947)			
Adjusted R^2	0.8535	0.7180	0.8582	0.8711	0.8508

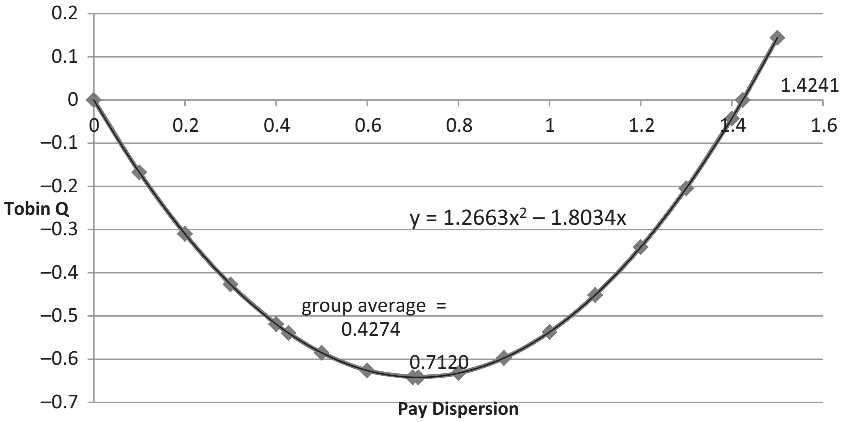

Fig. 13.3 Civil Law countries banks' P/B ratio

We only show the empirical results for the P/B ratio as our bank performance indicator.

Lastly, the empirical results for the sub-sample of Developing Country banks are reported in Table 13.9. We find that the residual distributions of these regressions are normal for the log (profit) indicator only, indicating that the translog profit specification is appropriate for our sub-sample of Developing Countries. Furthermore, the relationship between the variable of executive pay dispersion and the log(profit) indicator is depicted in Fig. 13.4. The coefficient of the quadratic term of pay dispersion is negative and significant at the 1% level, providing supporting evidence of the equity fairness theory for our sample banks in Developing Countries. Our empirical results can be interpreted as implying that greater pay dispersion has a negative impact on bank performance in China and India. The average executive pay dispersion of our sub-sample of Developing Country banks is 0.2515 (see Table 13.1) and we observe that total executive compensation is mostly composed of salary and the cash bonus in this sub-sample. As for the cultural control variables, we find that the Power Distance index is negatively associated with the bank operation performance indicator, log (profit). Similar to the results for the valuation indicators in Developed Countries, the Individualism index is positively associated with the bank operation performance indicator, log (profit). For the index of Uncertainty Avoidance, we find that it is negatively associated with operational performance, which is also consistent with earlier results for Developed Country valuations.

We summarize all of our empirical results in Table 13.10.

Table 13.8 Analyses on the P/B ratio—"a group of Common Law countries banks (27 banks)"

Performance indicators	The P/B ratio				
		Individualism	Power Distance	Masculinity	Uncertainty Avoidance
C			−68.8242**		
			(29.7236)		
Pay dispersion	0.0014	0.2336	−0.9696	0.1846	
	(1.2696)	(1.3814)	(1.3223)	(1.3519)	
(Pay dispersion)^2	−0.0084	−0.2606	0.8943	−0.2264	
	(1.0590)	(1.1995)	(1.0984)	(1.1684)	
Cultural Index		Individualism	Power Distance	Masculinity	Uncertainty Avoidance
		0.0119	−0.1563	0.0064	
		(0.0174)	(0.1039)	(0.0083)	
log(output)					
log(interestp/100)					
log(labourp)					
log(size)	7.7824*		12.3375**		
	(3.9412)		(4.6754)		
0.5*log(output)*log(output)					
0.5*log(interestp/100)*log(interestp/100)					
0.5*log(labourp)*log(labourp)					
0.5*log(size)*log(size)	−0.5760**		−0.8869***		−0.5534*
	(0.2810)		(0.3155)		(0.3171)

log(output)*log(interestp/100)					
log(output)*log(labourp)					
log(output)*log(size)					
log(interestp/100)*log(labourp)					
log(interestp/100)*log(size)					
log(labourp)*log(size)					
Widely owned			0.6394*		
			(0.3197)		
(defaultr/100)	−9.9962***	−8.4548***	−12.8108***	−8.3967***	−9.5484***
	(1.7676)	(3.0030)	(2.7920)	(2.8021)	(2.1907)
(tier1/100)					
Adjusted R^2	0.8566	0.8308	0.8237	0.8299	0.8190

Table 13.9 Analyses on the log (profit)—"a group of Developing Countries banks (29 banks)"

Performance indicators		Log(Profit)			
		Individualism	Power Distance	Masculinity	Uncertainty Avoidance
C					
Pay dispersion	−0.4111	−0.2782	0.2782	0.2782	0.2782
	(0.2815)	(0.2288)	(0.2288)	(0.2288)	(0.2288)
(Pay dispersion)^2	−0.4992*	−0.4301*	−0.4301*	−0.4301*	−0.4301*
	(0.2819)	(0.2295)	(0.2295)	(0.2295)	(0.2295)
Cultural Index		Individualism	Power Distance	Masculinity	Uncertainty Avoidance
		0.0133**	−0.1242**	−0.0373**	0.0373**
		(0.0059)	(0.0552)	(0.0166)	(0.0166)
log(output)					
log(interestp/100)					
log(labourp)					
log(size)	2.8143***	2.8547***	2.8547***	2.8547***	2.8547***
	(0.6186)	(0.5442)	(0.5442)	(0.5442)	(0.5442)
0.5*log(output)*log(output)					
0.5*log(interestp/100)*log(interestp/100)					
0.5*log(labourp)*log(labourp)					
0.5*log(size)*log(size)					
log(output)*log(interestp/100)					
log(output)*log(labourp)		0.6600*	0.6600*	0.6600*	0.6600*
		(0.3588)	(0.3588)	(0.3588)	(0.3588)

log(output)*log(size)					
log(interestp/100)*log(labourp)					
log(interestp/100)*log(size)					
log(labourp)*log(size)	0.1774***	0.1867***	0.1867***	0.1867***	0.1867***
	(0.0659)	(0.0589)	(0.0589)	(0.0589)	(0.0589)
Widely owned					
Ceodual					
(defaultr/100)	−17.3771***	−18.2121***	−18.2121***	−18.2121***	−18.2121***
	(4.7873)	(4.5979)	(4.5979)	(4.5979)	(4.5979)
(tier1/100)	3.4764*	3.6065***	3.6065***	3.6065***	3.6065***
	(1.4611)	(1.3181)	(1.3181)	(1.3181)	(1.3181)
Adjusted R^2	0.9956	0.9960	0.9960	0.9960	0.9960

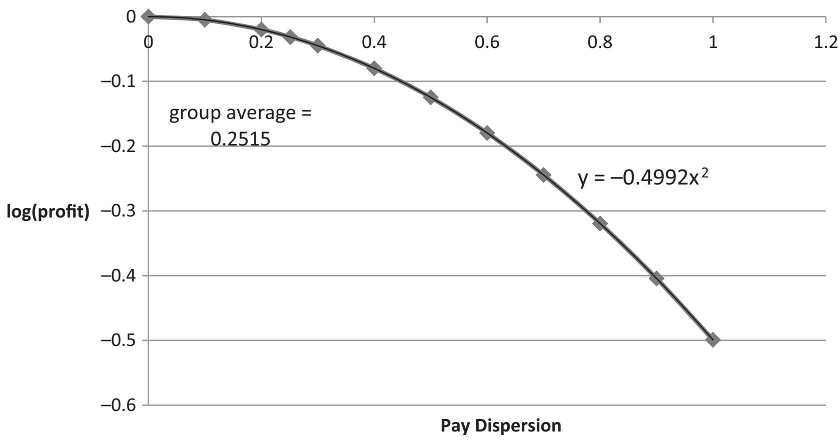

Fig. 13.4 Developing Country banks' log (profit)

Table 13.10 Summary of empirical results

Performance indicators	Log(Profit)	Tobin Q	The P/B ratio
Developed Countries (63 banks)	Neither*	Equity fairness theory; except for very high pay dispersion, the tournament theory holds (U-shaped impact curve) Individualism: positive + Power distance: not significant Masculinity: not significant Uncertainty Avoidance: Negative –	Equity fairness theory; except for very high pay dispersion, the tournament theory holds (U-shaped impact curve) Individualism: positive + Powerdistance:Negative– Masculinity: positive + Uncertainty Avoidance: Negative –
Civil Law (36 banks)	Neither*	Equity fairness theory; except for very high pay dispersion, the tournament theory holds (U-shaped impact curve) Individualism: not significant Power distance: not significant Masculinity: not significant Uncertainty Avoidance: not significant –	Equity fairness theory; except for very high pay dispersion, the tournament theory holds (U-shaped impact curve) Individualism: positive + Powerdistance:Negative– Masculinity: positive + Uncertainty Avoidance: Negative –

(*continued*)

Table 13.10 (continued)

Performance indicators	Log(Profit)	Tobin Q	The P/B ratio
Common Law (27 banks)	Neither	Neither	Neither
Developing Countries (29 banks)	Equity fairness theory Individualism: positive + Power distance: Negative – Masculinity: Negative – Uncertainty Avoidance: positive +	Neither*	Neither*

[a]Residuals of regression non-normal

Conclusion

The issue of pay dispersion has not received much attention in the banking literature. The main contribution of our study is to fill this gap using a study with global scope. In particular, we look at pay dispersion at the top executive level and test whether the tournament theory or the equity fairness theory is applicable to bank performance. Policymakers care about the design of executive pay at banks because of the systemic importance of banks and the use of taxpayer money to rescue failing financial institutions. One contribution of our study is to incorporate the notion that cultural factors may have an impact on how pay dispersion influences firm performance and valuation. By controlling for cultural differences across countries, our overall conclusion is that teamwork (arguing for smaller pay dispersion) is favoured over tournament in most groups of our sample. Lower pay dispersion is mostly effective in enhancing bank performance in a significant section of our sample banks, that is, Civil Law and Developing countries, China and India. With regard to the cultural variables, we find that two of the four cultural dimensions have a significant impact on the valuation indicators for our sample banks in Developed Countries. Individualism is positively associated with market valuation such as the indicators of P/B and Tobin's Q, while Uncertainty Avoidance has a negative relationship.

The level and the equity of pay have not been the focus of growth strategies in international business. After the global financial crisis, policymakers and shareholders have started paying more attention to the impact of executive pay structure for growth and stability. Our study provides supporting evidence of the need for lower executive pay dispersion in the banking industry given its overall positive implications on corporate performance in Civil Law countries and Developing countries, China and India.

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Appendix

Table 13.11 Common Law vs. Civil Law countries

Common Law	There are 27 banks in our sample that belong to this category and these banks are from • Ireland • USA • Australia • UK • Canada
Civil Law	There are 36 banks in our sample that belong to this category and these banks are from • Belgium • Spain • Portugal • Netherlands • Switzerland • Denmark • Norway • Austria • Sweden • Finland • Italy • Germany • France

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