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An Institutional Perspective on Foreign Direct Investment

A Multi-level Framework

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Abstract:

- The process of foreign direct investment (FDI) is inherently uncertain as decisions surrounding investments are impacted by fragmented environments which offer contested views as to appropriate actions.
- We propose a multi-level organizing framework of institutional influences on FDI and examine the differential effect of these forces at two points in time: Prior to a first investment and upon subsequent investments.
- We posit that upon initial entry, firms are impacted primarily by coercive host country pressures, industry mimeticism, and internal firm norms. We expect these influences to change on subsequent entries with normative forces having the most salience.

Keywords: Foreign direct investment · Institutional theory · Multiple-level framework

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Introduction

Research on foreign direct investment (FDI) has tried to explain the where (investment location), when (timing of entry) and how (entry mode) of foreign direct investment decisions, broadly defined as equity based investments including greenfield investment, joint venture and acquisition in a foreign country (Chang/Rosenzweig 2001, Dunning 1979, Johanson/Vahlne 1977, Kogut/Singh 1988, Madhok 1997). Historically, researchers have relied upon economic perspectives which suggest that firms choose strategies in attempt to achieve optimal solutions (Gatignon/Anderson 1988, Dunning 1979, Kim/Hwang 1992). However, when making investment decisions, firms face a multitude of uncertainties and are influenced by numerous and often conflicting information cues that do not always lend themselves to rational decision making models.

In recent years, the sociology-oriented institutional perspective has been introduced to the FDI literature (Chang 1995, Guillen 2002, Lu 2002, Martin/Swaminathan/Mitchell 1998, Martinez/Dacin 1999, Roberts/Greenwood 1997). The institutional perspective view firms as social actors, who do not have complete information about the economic efficiency and effectiveness of their strategies ex-ante (Meyer/Rowan 1977). Firm decisions and behaviors are nested within historical and cultural contexts and, in order to reduce uncertainty, firms look for cues from their social environment and interactions with other firms in order to gain information about potential opportunities, constraints and the legitimacy of their actions.

While research on FDI has begun to acknowledge the existence and criticality of institutional forces, it has not dealt yet with the issues of selective attention and goal prioritization for firms making strategic choices. Firms are presumed to heed all types of institutional pressures at all times and to yield to such pressures whenever they encounter them (Oliver 1991). Some researchers have already acknowledged the often conflicting results from foreign entry studies and suggest institutional theory as a means for explaining them (Delios/Henisz 2003). We believe investigating the diverse institutional pressures on FDI decisions more fully will shed light on such conflicting results.

Decision makers, constrained by bounded-rationality, cannot and do not uniformly conform to all institutional pressures (Oliver 1990, Simon 1947). March and Simon (1958) suggest that decision makers utilize their limited attention to focus on key threats and opportunities when making their choices. This “attention based” view of the firm highlights the criticality of attention structures, rules, resources and attention-directors within a firm to direct managerial attention to focus on select stimuli (March/Shapira 1992, Ocasio 1997). Oliver (1991) builds on the institutional perspective to propose that firms can respond differently to the same environmental pressures with actions ranging from acquiescence or compromise, to avoidance, manipulation and even outright defiance.

This paper applies and integrates those insights from decision making literature to the decisions on FDI. We argue that firms respond selectively and differentially to external influences based on the sources of institutional pressure, the intensity of the pressure exerted, and their own previous experience for dealing with such pressures. We advance the institutional perspective (Greve 1998, Guillen 2002, Haveman 1993, Henisz/Delios 2001) to explain the influences of multiple sources of institutional factors on foreign direct investment. We view a firm’s foreign investment as analogous to market entry,

i.e., a type of strategic change that is largely under the influence of interorganizational variables (Guillen 2002, Haveman 1993). To be parsimonious, we focus our discussion on the probability of foreign direct investment (through equity based investment of joint venture, acquisition or greenfield investment) into a particular host country (Greve 1998, Guillen 2002, Haveman 1993, Henisz/Delios 2001). We believe that institutional forces are more critical in explaining the entry mode of foreign direct investment than other modes of market entry, such as exporting (Johanson/Vahlne 1977) and licensing (Contractor 1981), because FDI requires a high level of resource commitment and has a high level of risk exposure to environmental influences (Johanson/Vahlne 1977). As compared to FDI, exports are subject to more ad hoc factors and licensing essentially shifts the risk to the licensees. As such, we expect the influence of institution pressures to be most evident in FDI decisions.

We develop a framework to highlight the broad array of institutional pressures on probability of foreign investment into a host country. Our contribution lies in fusing the decision making perspective into the institutional perspective on FDI. By proposing that decision makers selectively attend to and yield to the institutional pressures that they face, we elaborate on the role of managers in multinational firms and how they interact with their environments. Our goal is to conceptually explain the location of foreign investment within a framework derived from institutional theory and to propose a theoretical model that can be empirically tested in future research. In the concluding part of the paper we suggest empirical operationalizations of our key constructs as well as areas for future empirical research.

Foreign Direct Investment and Institutional Influences

Previous researchers have highlighted the role of institutional pressures in the highly uncertain process of internationalization (Henisz/Delios 2001, Lu 2002). Institutional theory suggests that organizations operate in uncertain, complex and sometimes conflicting environments and in the process of making sense of the external environment, they gain a "common understanding of what is appropriate and fundamentally meaningful behavior" as influenced by various types of institutions: State, industry and profession (Zucker 1988, p. 105). Legitimacy is the prerequisite for survival and in seeking legitimacy (see Jensen 2003), firms are driven to isomorphism, the process that forces one unit in a population to resemble other units facing similar environmental conditions (Dacin 1997, Deephouse 1996, DiMaggio/Powell 1983, Suchman 1995).

Previous studies that use institutional theory to explain foreign investment decisions fall into three basic areas (Xu/Shenkar 2002). One area focuses on how organizations respond to country-level institutional forces such as the formal rules, institutions and enforcement mechanisms sanctioned by the state (Brouthers/Brouthers 2000, Goodrick/Salancik 1996, Huang/Sternquist 2007, Scott 1995). Researchers have explored the concept of institutional distance, i.e., the extent of similarity or dissimilarity between the regulatory, cognitive and normative institutions of two countries (Kostova 1999, Xu/Shenkar 2002). Research shows that when there is a large degree of distance, firms prefer lower levels of equity investments (Xu/Pan/Beamish 2004). A second area emphasizes the social nature

of institutions and the interactive influence of imitation among firms and the ensuing isomorphism (Guillen 2002, Haveman 1993, Henisz/Delios 2001, Yiu/Makino 2002). For example, in a study of Japanese firms entering multiple countries, Lu (2002) found that later entrants tended to follow the example of earlier entrants in using the same foreign market entry modes. A third research stream takes into account the interaction among the subsidiaries of a multinational (Ghoshal/Bartlett 1990, Xu/Shenkar 2002). These studies analyze the need for internal legitimacy extending from the head office or subsidiaries. As a case in point, Davis, Desai, and Francis (2000) found that SBU's entering foreign markets using wholly owned entry modes demonstrate high levels of internal isomorphism with their network siblings.

Even though this stream of research illustrates the usefulness of institutional theory to understand FDI behavior, previous researchers have not investigated the institutional environment at its multiplicity and examine how firms behave when facing conflicting demands from the environment. Organizations interact with and are influenced by "fragmented environments", (D'Aunno/Sutton/Price 1991) which can offer contesting sources for legitimization. Internationalizing firms operate in complex and multi-faceted institutional environments and experience pressures emanating from host country conformity, industry mimicry, as well as the extension of integrated internal actions and practices (Ghoshal/Westney 1993, Kostova/Zaheer 1999, Sundaram/Black 1992). In order to make viable choices, firms need to consider information cues from all of these sources to determine what information is most salient.

While some researchers acknowledge multiple sources of institutional pressures (Chan/Makino/Isobe 2006, Davis/Desai/Francis 2000, Lu 2002), little research has explored the relative importance of these pressures. As stated previously, bounded-rational decision makers cannot perceive, attend to, and yield to all pressures from their environment. Instead, they prioritize and opt for satisficing the most critical pressures at a given time. Importantly, the interests, cognitive limitations, and considerations of decision makers have not generally been incorporated into theorization in institutional theory. Also, since internationalization is an iterative process that comprises of commitment, learning and further commitment (Johanson/Vahlne 1977, Johanson/Wiedersheim-Paul 1975), there are a wide range of institutional sources exerting varying levels of pressure at various points in time. Therefore, the focus and primary concerns of decision makers shift at various stages of the process and as a result, different isomorphic pressures are attended to during the various stages of investment.

Isomorphic Mechanisms within Institutional Environments

As there are risks involved in making foreign investments, particularly an initial investment, a firm is concerned with aligning the firm, its design and configuration, with the demands of the target country. Facing a vast, complicated array of choices and alternatives, decision makers rely on a few rules and heuristics to make their decisions (Cyert/March 1963, March/Simon 1958). One method relates to how decision makers set their expectations and the levels at which they evaluate their performance after completing the task (Greve 2003). For example, managers can take the decision making shortcut of satisficing, defined as settling on some alternative that meets the minimum requirements

(Moyer 2007). Alternatively, managers can set goals and strategies that aspire to a high level accomplishment. We believe decision makers respond to institutional pressures differently and make choices based on whether he/she is focusing on satisficing or future aspirations. While they satisfice the most critical pressures of the institutional environment to ensure survival, once those pressures have been complied with, he/she diverts attention to other aspects of the institutional environment to achieve growth goals and aspirations (Greve 2003, March/Shapira 1992).

In understanding the link between the focal point and pressures of the institutional environment, it is helpful to refer to DiMaggio/Powell's (1983) research describing the different types of isomorphic mechanisms at work in the institutional environment. They suggest three basic types of pressures emanate from the environment acting as influences on organizations; these include coercive, mimetic, and normative forces. The distinction among these three institutional mechanisms is that they shape the way in which contests between different sources for legitimacy are being controlled: "Coercive" (through political and legal power as well as general resource dependency), "mimetic" (imitating "best practices" in conditions of uncertainty), and "normative" (the existence of a professional consensus) (Lodge/Wegrich 2005). For firms investing in foreign markets, we expect these isomorphic mechanisms to occur simultaneously across country, industry and firm environments as sources of institutional pressures.

Coercive isomorphism stems from "political influence and the problem of legitimacy" (DiMaggio/Powell 1983, p. 150) and results from formal and informal pressures exerted by nations, from other focal organizations, and from within the firm itself (Guler/Guillen/Macpherson 2002). At the national level, firms investing internationally can experience tremendous coercive forces from the regulatory environment, including rules mandating ownership restrictions, local content, operating constraints, taxation rates, and the repatriation of profits. The fundamental mechanism providing coercive forces their power is the lack of legitimacy that results from nonconformity leading to penalties such as denied entry, demise or exit. Investing firms must comply with the coercive legal regulations of host countries (Doz/Bartlett/Prahalad 1981, Rosenzweig/Singh 1991). As Rosenzweig and Singh (1991, p. 348) argue, "to the extent that the state imposes specific regulations regarding pricing policy, labor practices, or other aspects of management, the subsidiary may have little choice but to conform".

Coercion from industry sources, while rarer and less formal than country pressures, can be significantly powerful. Within certain industries, regulatory standards created for participating firms require compliance to gain legitimacy. In foreign investment, the adoption of industry mandates bestows legitimacy on investing firms and creates uniformity among individual firms. Similarly, firms can experience coercion from internal sources as MNE's can exert pressures over subsidiaries through resource dependence or front office mandates. In some situations, subsidiaries are required to adopt practices that enhance the global integration of the MNE or to protect the survival of the entire network. For example, software gaming firms such as Electronic Arts and Nintendo rely on intellectual property as their competitive advantage and are extremely cautious about software infringement and code leakage (Nintendo 2008). As a result, when entering countries without effective intellectual property protection, such as China, they restrain or delay subsidiaries from selling game software through normal distribution channels. Instead,

subsidiaries must develop alternative products or distribution methods, such as encrypted software or online gaming platforms where there is less opportunity to loose intellectual property (Investor.EA.com 2007).

The above discussion details several types of coercive pressures from national, industry or firm sources which restrict or constrain the strategic choices of investing firms. We expect that when faced with strong coercive pressures from these sources, firms will be less likely to invest into a host country. Thus, we draw our first proposition.

Proposition 1a: A firm's probability of investing in a particular foreign market is reduced if there are country, industry or firm coercive pressures.

In contrast to coercive pressures, which might inhibit foreign entry, mimetic forces at the country, industry and firm levels are likely to promote investment into a country. Mimicry takes place in the face of uncertainty, when organizations need to search for familiar alternatives and seek to economize search costs (Cyert/March 1963, DiMaggio/Powell 1983). Mimicry or mimetic behavior is also an important consideration for gaining external legitimacy from actors at the industry-level. Lu describes, "Institutional theorists argue that imitation comes about because prior decisions or actions by other organizations increase the legitimacy of similar decisions and actions," (p. 23, 2002) and imitation is particularly important in the face of high uncertainty (DiMaggio/Powell 1983, Tolbert/Zucker 1983, Haunschild/Miner 1997). Such decision making economizing leads a focal organization to scan their environment, observe the behavior of others and model itself after others as a means of seeking legitimacy (Guler/Guillen/Macpherson 2002).

During internationalization, decision makers may imitate the behaviors of organizations in other countries, other firms in the same industry, and the behaviors of previous internal actions by the parent organization. The first type of imitation refers to country level mimicry which occurs when a firm draws on models of successful entries into a host country, regardless of the home country, industry or line of business. For example, Guler, Guillen and Macpherson (2002), in their investigation of cross country diffusion patterns of ISO 9000 quality certification, found that firms in one country imitate those in other countries if the two are role-equivalent in the international trade network. We expect similar mimeticism to take place in foreign investment. Similarly, industry and firm mimicry arises when firms imitate relevant models of investment behavior from others within their industry or from subsidiaries within the parent organization network. Research suggests that these are particularly useful models for imitation as firms tend to imitate large, successful or similar-sized rivals, whose behaviors are easily observable and/or perceived to be salient to the focal firm (Haveman 1993, Haunschild/Miner 1997). In the case of FDI, Gimeno, Hoskisson, Beal and Wan (2001) found that firms in the telecom industry imitate each other's international entries. Similarly, Chang and Rosenzweig (2001) found that firms tend to use the same mode of entry as earlier entries in a new country. Based on this discussion, we propose the following:

Proposition 1b: A firm's probability of investing in a particular foreign market increases if there are strong country, industry and firm mimetic pressures.

The last mechanism at work in the institutional environment is normative isomorphism (DiMaggio/Powell 1983). Normative isomorphism stems from a logic of appropriateness, which invites and compels an organization to act in a certain way (DiMaggio/Powell 1983, Scott 1987). It results from the collective struggle of members in a population to define the conditions and methods of their work, to establish a shared norm of who they are and how they behave and in the process of doing so, legitimize themselves. Such normative isomorphism can be evident in the concept of national culture at the country level (Hofstede 1980), the professionalization and formalization of a field at the industry level (Larson 1977), and the promotion of best practices and the perpetuation of organizational culture at the firm level.

Normative influences at the country level will be stronger if the normative dimension of the host country and home country profiles are close. In other words, if the two countries share similar societal beliefs, desired goals and the appropriate means to achieve them then the institutional distance between them is smaller (Xu/Shenkar 2002). Rosenzweig and Singh (1991) maintain that during international expansion firms are pressured to conform to the national environment of the host country, while also facing pressure to transfer its firm-specific competitive advantages to the host country subsidiary. The closer the host country is to the home country in terms of country norms, the easier it is for the foreign entry to transfer its routines, capabilities and ways of operation from the home country to the host country since the host country stakeholders (employees, customers, supplier etc.) request little or no justification for the imported routines.

Normative pressures at work within an industry occur when groups utilizing common technologies, labor resources, and partners develop collective understandings of what is legitimate behavior. Strong industry norms are evident in the professionalization of an industry, where firms converge to similar methods of operation, HR recruiting, training, and promoting. Positions within industries often require similar, transferable skills. Industries promote norms through education and professional organizations and often straddle international borders. Strong norms at the industry level mitigate and reduce differences between countries such that firms in one country might exhibit more similarity to their professional counterparts in other countries, rather than to host-country firms in other industries.

Normative pressures at the firm level include the presence of strong organizational culture and interdependence throughout an MNE's operations leading to parent isomorphism (Rosenzweig/Singh 1991). These pressures include a multinational firm's prior international experience, its prevailing and preferred structures, cultures, control mechanisms, systems, procedures, and practices. Shared cognitive and social beliefs provide uniform interpretive schemas for subsidiaries and facilitate strategic sense-making and interpretation (Douglas 1986). Empirical research indicates that the intertwining of activities between parent and subsidiaries is related to conformity of practices across borders (Davis/Desai/Francis 2000, Robinson 1995). For firms where there are strong internal norms, subsidiaries go to extra lengths to conform. Overall, we expect strong norms at multiple levels will increase the intensity of investment by entering firms. Based on this discussion we propose the following:

Proposition 1c: A firm's probability of investing in a particular foreign market increases if there are strong country, industry and firm normative pressures.

The Relative Importance of Three Forces: Prior to Initial Entry

The first set of propositions (Proposition 1a, 1b, 1c) outline the isomorphic pressures emanating from multiple relevant sources for investing firms. The next set of propositions explains the conjunctive effects of these forces prior to a firm's initial entry (Proposition 2) and for subsequent investments (Proposition 3). We argue that when a firm makes decisions about its initial foreign entry, the three isomorphic forces do not have the same salience across all the levels of analysis. We present a guiding, integrated framework of these forces in Fig. 1 which is discussed below.

Prior to entry, coercive forces are most powerful at the country level, mimetic forces most salient at the industry level, and normative forces most salient at the firm level (see the highlighted diagonal cells of Fig. 1). In other words, prior to entry, firms are most likely to comply with coercive forces at the country level, mimetic forces at the industry level and normative forces at the firm level. Comparatively, firms are likely to pay less attention to, avoid, or even resist the other forms of isomorphic pressures elsewhere, such as coercive forces at the industry and firm level, the mimetic forces at country and

Levels of Analysis

Isomorphic Pressures	Country	Industry	Firm
Coercive	*Laws constraining ownership, between country transfers and operational control.*	*Industry association regulations restricting individual firm activities*	*MNE rules mandating organizational practices.*
Mimetic	*Imitation of successful country entrants.*	*Imitation of industry competitors.*	*Imitation of MNE siblings and previous entries.*
Normative	*Cultural expectations within host country.*	*Professional practices and industry standards.*	*MNE control mechanisms and shared beliefs.*

Primary Influences at Initial Entry (Country, Industry) → ***Primary Influence for Subsequent Entries*** (Firm)

Note: Highlighted cells indicate the high degree of relevance for each type of isomorphic pressure at each level of analysis. These relationships are explained by propositions 2a, 2b and 2c.

Fig. 1: Framework of Isomorphic Pressures at Multiple Levels during International Entry

firm level and the normative forces at country level and industry level. A firm's reaction is based primarily on the strength of institutional forces at each level resulting from their different control and enforcement mechanisms for imposing their influence on firms. As a result, firms incur different penalties and consequences in the case of non-conformity. Country, industry and firms rely on distinctive control mechanisms to exert their influences on decisions makers: Countries rely primarily on legal coercion and government mandates, industries on competitive diffusion, and MNE's on administrative and resource control and coordination mechanisms (DiMaggio/Powell 1983, Pfeffer/Salancik 1978, Scott 1987).

As described earlier, investing firms must comply with regulations by host and home countries, their legal systems and governmental mandates (Doz/Bartlett/Prahalad 1981). Host country regulations abound in foreign investments, limiting the responses of foreign firms for coping with country level coercion. In anticipation of the potential benefits of foreign investment, firms can choose to acquiescence and comply with regulations when entering a host country. However, if country level coercion diminishes the benefits of investment significantly, firms can choose to avoid these pressures by not entering the country. There is little room however, for foreign firms to voice their dissent and/or to manipulate the system since the nation state has sovereign power (Hirschman, 1970). Henisz and Delios (2001) also note that there are limited choices for firms when facing country sovereign power and, what they refer to as, "political uncertainty", which arises from the vicissitudes of the policymaking apparatus in a host country. They find that although a firm's experience helps it cope with market unfamiliarity it does not help it cope with political uncertainty (Henisz/Delios 2001).

Comparatively, firms have relatively more negotiation power and more response choices when facing coercive pressures from industry as well as internal firm sources. First, pressures of this coercive type are relatively rare. Second, when industry and firm level coercive forces are present, they resemble precedents rather than the laws and regulations of a nation-state. Industries are loosely coupled systems and fields with moving boundaries. As Porac, Thomas, Wilson, Paton and Kanfer (1995, p. 203) argue, "market boundaries are socially constructed around a collective model that summarizes typical organizational form within an industry". In a socially constructed model, coercive forces at the industry level, such as complying with standards, can be interpreted or even modified if they do not suit the firm's interests. Options range from choosing to join or leave collusion, or voicing concerns to other members in their association in an effort to negotiate with the group to change its policies.

An investing firm has even more power in coping with coercive power exerted at the firm level. Ghoshal and Bartlett (1990) argue that relationships between headquarters and subsidiaries are increasingly more similar to nodes in an interorganizational network, as opposed to one-way hierarchies. Current conditions encourage MNEs to radiate power away from head offices to its operating companies and recast the relationship of head office and subsidiary into a partnership. Subsidiaries do not necessarily need to implement "orders" from headquarters per se, but have more room to modify and adjust "orders" to local conditions. Thus,

Proposition 2a: Ceteris paribus, in making foreign investment decisions, firms take into account *country coercive* pressures more than industry or firm coercive pressures.

Regarding mimetic forces, when making an initial investment decision into a particular country, we argue that mimicry is most salient at the industry level. In deliberating upon its first entry into a new host country, a decision maker faces information constraints (Martin/Swaminathan/Mitchell 1998). They need information on the size, growth, and market potential of new markets, as well as the likelihood that they can take advantage of any opportunities. As discussed earlier, there are several methods for reducing uncertainty, one of which is imitation of local competitors in the host country, industry counterparts who have entered the host country, or other subsidiaries within the same MNE.

We expect that home country rivals that have entered the host country are more likely to be salient as the observed information is reliable and relatively abundant. Firms have more information about competitors in home market industries than firms in other countries and any observed experience is highly congruent and applicable. Empirically, there is some evidence of such imitation occurring. Martin, Swaminathan and Mitchell (1998) found that firms are most likely to expand internationally after the first entry of its current competitors. In regarding other mimetic models, a decision maker must consider their own "liability of foreignness" and differences in heritages (Hymer 1976, Zaheer 1995). Local competitors in host countries enjoy advantages that foreign firms do not have, such as familiarity to the local environment, understanding of local culture, and closeness to customers in the market (Hymer 1976). Their strategies and performance levels may not be appropriate as guides for potential entrants. In addition, focal firms might not imitate other subsidiaries in its MNE system even though they are part of the same network. Their experience might be country-specific and not transferable. Indeed, the penalty for not obtaining external legitimacy by ignoring mimetic pressures to conform to local external pressures can be quite severe. For example, in examining the reasons as to why Home Depot failed in Chile, Bianchi and Arnold (2004) note that the company failed to obtain external legitimacy and did not follow the prevailing standard practices in the retailing industry in Chile. Overall, we suggest that focal firms rely more heavily on the relevance and applicability of the experiences of industry counterparts more than other available mimetic models when entering a foreign country. Thus we propose,

Proposition 2b: Ceteris paribus, in making foreign investment decisions, firms take into account *industry mimetic* pressures more than country or firm mimetic pressures.

We argue that normative forces are more evident at the firm level, as opposed to country and industry levels, when firms make their initial foreign investment decisions into a host country. As stated previously, normative forces are created through the process of group members to collectively define what they do, their collective identity and establish a cognitive base of who they are (DiMaggio/Powell 1983). For an organization contemplating foreign entry, we maintain that the most immediate, salient, central and enduring normative characteristic is organizational identity, as opposed to industry identity or country

identity (i.e. national culture) (Albert/Whetten 1985). These other levels of collective understanding of "what we do" and "who we are" are important, however, a firm, in a competitive arena is always trying to differentiate itself from others. Organizational level identity is a means for doing so. In contemplating a potential foreign entry, the decision maker is more likely to ask "is this move going to benefit the bottom line and the core capabilities of the firm and contribute to the overall organization?" rather than examine the normative implications to industry and country norms. Thus,

Proposition 2c: Ceteris paribus, in making foreign investment decisions, firms take into account *firm normative* pressures more than country or industry normative pressures.

The normative forces within a multinational network have to be viewed with caution, especially if the internal normative forces at the firm-level clash with the external mimetic forces at the industry-level. In the case mentioned previously of Home Depot's failure in Chile, while the Chilean subsidiary ignored mimetic industry practices, it largely followed and conformed to the firm-level normative pressures (Bianchi/Arnold 2004). Normative pressures compelled the Chilean subsidiary to follow Home Depot's global strategy of transferring past successes to its new units. Home Depot assumed, wrongly as it turned out, that its competitive advantage and other practices would work at all locations and that it did not have to customize its internal structure, systems, and processes when making new foreign investments.

The Relative Importance of the Forces for Subsequent Entries

We argue that the relative importance of the three levels of institutional influences differ depending on what stage of the entry process the firm is in. (See bottom of Fig. 1). After initial entry into a host country, a firm gains first hand experience of its new market causing two fundamental shifts: The priority and salience of focal firm's institutional pressures and its proximity to the market. Once a firm has entered a host country, it has already made the decision of whether to comply with its laws and regulations. Consequently, coercive forces are no longer the major concern for firms in their follow-up entries into the host country. Not only that, but we expect that a firm's bargaining power may increase at its seeks to make subsequent investment leading it to mitigate the country effects.

For follow-up investments, decision makers provide less attention to country mandates and regulations and more to building, developing and exploiting their capabilities (Chang 1995). After investing in a host country, a firm begins to obtain immediate, practical, experiential knowledge about customers, distributors, and local competitors. In such situations, its own experience is a better guide of what to do and what not to do in the host country. We also expect a focal firm to shift from imitating others to considering its prior entries, norms and history. When mimetic forces are strong, it is mostly due to a sense of uncertainty that arises due to a lack of experience (Barkhema/Bell/Penning 1996). Inexperienced firms are uncertain about the current and future potential of a foreign market as they have no formula that they have developed from past experience in approaching investment decisions (Lu 2002). As a consequence, such firms have externally-oriented

search routines that focus on other firms in the industry and on country-level factors (DiMaggio/Powell 1983, Haunschild/Miner 1997). When experience is gained a shift occurs within the firm to an emphasis on internal norms and organizational integration.

This shift is evidenced in Chang and Rosenzweig's (2001) investigation of sequential entries of Japanese firms into the U.S. They find that factors such as competitive advantage, business line diversification and cultural distance explain a firm's initial mode of entry into the US market, but do not explain the modes of their subsequent entry. The factors that promote initial entry resign to firm level factors such as the extension of organizational capabilities, replication of existing knowledge in a new location in the host country, as well as the "fit" between the new investment and organizational image. Therefore, we argue:

Proposition 3a: Upon its initial entry, a firm's probability of investment into a particular foreign market is primarily influenced by country and industry pressures.

However, once a firm has a certain level of experience with regard to foreign investments, its search with regard decisions about new international markets will tend to be more internal. Here the argument is that it has sufficient knowledge and experience based on its past activities to search within its boundaries on which to base its decisions. This explains the greater internal orientation that results from experience. Therefore:

Proposition 3b: For subsequent investments into a particular foreign market, a firm is influenced more by firm (coercive, mimetic and normative) pressures than by country or industry pressures.

Discussion and Conclusion

Our paper provides an institutional perspective on how decision makers make sense of the multiple pressures they face when investing in foreign markets. The issues of uncertainty, risk, and imitation are not unknown in the FDI literature; however, the questions of how to deal with the combined isomorphic pressures of coerciveness, mimicry and normative forces have not been elaborated upon. In this article, we address the effects of uncertainty generated at three levels – country, industry and firm – and how firms respond to the pressures from those diverse forces. We develop a framework (see Fig. 1) to help researchers and managers understand the effect of uncertainty on firm decision making at different time points during the internationalization process. In developing this model, we emphasize that the uncertainty being generated at the different levels of country, industry and firm have varying salience on a firm's decisions. This is related to the power of each mechanism's influence to legitimate firm actions and the consequences they impose on a focal firm in the case of non-conformity.

We highlight the complexity of isomorphism (i.e., isomorphism at multiple levels) and its changing nature at different stages of investment (Kostova/Zaheer 1999). Previously, Kostova and Zaheer (1999) have highlighted the pressure of isomorphism and importance

of legitimacy in MNEs and illuminated the environmental and organizational complexity in the legitimation process. We explore further in order to understand such "complexity" and discuss its dimensions: The different levels of isomorphism (country, industry and firm levels), the relative weight of these forces, and their conjunctive influence on decision makers at different points in time in the internationalization process. This attempt to clarify the complexity of the foreign entry process provides a clearer understanding, as well as a guide for future empirical research in operationalizing institutional influences.

Our propositions are consistent with previous empirical research in the foreign direct investment literature. In the application of institutional theory, Henisz and Delios (2001, p. 443) make the distinction of firm-specific uncertainty, which they refer to as the "uncertainty derived from an organization's unfamiliarity with market characteristics", and policy uncertainty, which they refer to as "the uncertainty derived from characteristics of the policymaking apparatus of a market that make the characteristics of the market unstable or difficult to forecast". They find that imitation generally reduces uncertainty, particularly firm-specific uncertainty, but does not reduce political hazard related uncertainty (Henisz/Delios 2001). Viewed from our framework, this finding is not surprising as industry-based imitation cannot override country level coercion. The coercive forces at the country level are most deterministic prior to initial foreign entry since they leave firms with limited strategic responses. Firm level experiences and characteristics could not mitigate country level coercion. After initial entries and with the relaxation of country pressures, other forces become more salient to investing firms. Indeed as described previously, Home Depot's experience in Chile makes clear (Bianchi/Arnold 2004), following firm-level normative pressures do not mitigate the subsidiary from industry-level mimetic pressures. Ignoring mimetic forces proved to be very costly for Home Depot, suggesting that inter-firm external legitimacy may be more important than intra-firm internal legitimacy.

While there have been some work empirically testing institutional theory, the application of this theory to foreign market entry is relatively new. Our integrated framework (Fig. 1) indicates many areas for future research. The following table provides some direction for future research by providing examples of the country, industry and firm level isomorphic mechanisms (Table 1).

The framework and propositions presented here are part of a growing stream of institutional literature that investigates how the pressures of isomorphism influence firm behaviors and structures (Greve 1995, Haveman 1993, Strang/Meyer 1993, Strang/Tuma 1993). As noted in Huang and Sternquist (2007), developing appropriate measures for assessing institutional constructs can be challenging. Existing research, both from institutional and other streams of research provide guidance as to how to measure country, industry and firm influences. For example, country level coercive forces have been measured by the presence of restrictive governance mechanisms within a host country (Davis/Desai/Francis 2000). Firm coerciveness has taken the form of parent control or influence (Brouthers/Brouthers 2000). Literature on multi-market competition provides many examples of studies exploring competitive imitation within strategic groups and industries (Evans/Kessides 1994, Gimeno/Woo 1996, Makino/Delios 2000). Also, there is a wide range of literature on early movers and late followers (Garcia-Pont/Nohira 2002, Henisz/Delios 2001, Lu 2002) that is applicable to the imitation of firms following competitors into for-

Table 1: Operationalization of Institutional Pressures

Description	Examples of Institutional Mechanisms	Empirical Studies Operationalizing these Concepts
Country-level -coercive	High tariffs or taxes Ownership or partner requirements Transfer restrictions Progress of Institution development	Davis/Desai/Francis (2000) Henisz/Delios (2001) Meyer (2001)
-mimetic	Imitation of successful country entrants	*Shaver/Mitchell/Yeung (1997), *Yamawaki (1998), Henisz/Delios (2001), Lu (2002)
-normative	Importance or quality of formal institutions such as private ownership of business, banking sector reform, foreign exchange and trade liberalization, and legal development	Meyer (2001) Bevan/Estrin/Meyer (2004)
Industry-level -coercive	Industry regulatory agencies (FDA)	*Fitzgerald Bone/France (2003)
-mimetic	Early movers vs. followers Action-response competitive rivalry dyads Multimarket competition and mutual forebearance	*Baum/Li/Usher (2000), *Isobe/Makino/Montgomery (2000), *Rosenkopf/Abrahamson (1999), *Chen/MacMillan (1992), *Chen/Smith/Grimm (1992), *Evans/Kessides (1994), Gimeno/Woo (1996)
-normative	Type of industry membership	*Hill/Hwang/Kim (1990), *Kim/Hwang (1992), Makino/Delios (2000)
Firm-level -coercive	Investment size of the subsidiary vs a vis the parent Level of autonomy given to SBU's	Brouthers/Brouthers (2000), Davis/Desai/Francis (2000)
-mimetic	Previous international entry experience Subsidiary entry patterns	*Erramilli (1991), *Cho/Padmanabhan (1995), *Chang (1995), Lu (2002)
-normative	Degree of resource interdependence between parent and business units	Davis/Desai/Francis (2000), *Kim/Hwang (1992)

Note: The operationalization of isomorphic pressures is provided as a means to conceptualize and facilitate further research. It is not intended to constitute an exhaustive literature review.

*These studies did not test institutional theory in foreign market entry, but do provide examples of variable measurement that could be extended into research in this area.

eign markets. Lastly, normative effects have been measured as the degree to which strong bonds exist within firms through resource interdependence (Davis/Desai/Francis 2000) or within industries through networks (Makino/Delios 2000, Kim/Hwang 1992).

Our framework is one of the first to attempt to comprehensively integrate institutional theory, which traditionally emphasizes the "have to" aspect of firm choices, with the initiative, learning, risk preferences of the decision maker that make those choices. This intersection of constraints and choices is a fertile area for future empirical and theoretical work. Future research should continue to investigate the questions posed in our paper: What are the most powerful institutional pressures for firms investing in foreign markets? How important are each source respectively and in relation to each other? As Scott (2001) suggests, institutional forces should be considered as mutually reinforcing and interdependent. Another interesting area of research could investigate the sources of institutional pressures. For a more individualistic culture, the pressures of isomorphism might come from government mandates, rather than industry imitation. For a more collectivistic culture such as China, the pressures of isomorphism might be from industry imitation. A third primary research program can investigate why decision makers choose to respond to certain institutional influences and not others. As we have proposed in this paper, there are numerous pressures on firms from the institutional environment. We have suggested that from a learning perspective, knowledge or previous experience would offset certain coercive pressures and create conditions for optimizing other mimetic or normative pressures. However at this point, very little research exists in explaining why firms may conform or defy various isomorphic pressures and as such, more research is needed in this area.

Our paper has emphasized the initiative of the decision maker when facing the constraints of isomorphic forces from multiple levels. Our work advances the stream with the institutional literature that emphasizes social agents' differential initiative, their receptivity to institutional forces and their heterogeneity (Strang/Meyer 1993, Strang/Tuma 1993). The stance of decision makers, in the face of institutional constraints, is one of active choice, change and challenge. Individual initiatives and considerations are as important as political and social structures in shaping the behaviors of social agents.

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