Journal of World Business xxx (xxxx) xxx–xxx

Contents lists available at ScienceDirect

Journal of World Business

journal homepage: www.elsevier.com/locate/jwb

Home bitter home: How labor protection influences firm offshoring

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ARTICLE INFO

Keywords:
Home country
Labor protection
Offshoring
Labor productivity
Employee stock ownership

ABSTRACT

Drawing on the home country literature, we argue that firms headquartered or located in countries with strong labor protection may face challenges in their domestic operations. These firms are likely to initiate offshoring to enhance operational efficiency. Building on this argument, we also examine the boundary conditions moderating this proposed effect including labor productivity and employee stock ownership. Results based on a sample of information technology firms operating within five developed countries during 1990–2010 provide support for these arguments. These findings suggest that offshoring can be a partial exit strategy for firms to address the institutional challenges in their home country.

"Rules on severance pay and employee rights make it expensive and time consuming for the German software maker SAP to manage its costs" (Boudette, 2002).

1. Introduction

One of the fastest growing themes in international business (IB) research is the impact of home country on firms (Cuervo-Cazurra, Meyer, & Ramamurti, 2015; Estrin, Meyer, Nielsen, & Nielsen, 2016; Hoskisson, Wright, Filatotchev, & Peng, 2013; Marano, Arregle, Hitt, Spadafora, & Van Essen, 2016). The home country environment is crucial for firms to tap into the global market, because global market, provides important resources and assets that the firms can use for operations abroad (Cuervo-Cazurra & Ramamurti, 2017; Luo & Tung, 2007). Overall, home country institutions "facilitate both production and distribution of generated rents" (Hoskisson et al., 2013, 1297). Consequently, research shows that home country conditions may greatly influence firm strategies (Chakrabarti, Vidal, & Mitchell, 2011; Peng, Wang, & Jiang, 2008; Shi, Sun, Yan, & Zhu, 2017), internationalization motives (Luo & Wang, 2012; Witt & Lewin, 2007), and performance outcomes (Chacar, Newburry, & Vissa, 2010; McGahan & Victer, 2010).

Within the home country literature, researchers maintain that emerging market multinational enterprises (EMNEs) may differ in their internationalization strategies vis-à-vis firms based in developed countries (Luo & Zhang, 2016). EMNEs may to be more active in going abroad in order to cope with the challenges of home country operations. For example, some firms operating within emerging markets actively engage in foreign direct investment (FDI) in order to acquire more advanced know-how (Cuervo-Cazurra & Ramamurti, 2014, 2017; Kedia, Gaffney, & Clampit, 2012; Li, Li, & Shapiro, 2012). As useful as these studies are, little research has specifically examined: (1) whether other crucial home country resources—especially labor—may matter, and (2) how firms operating within developed countries use other internationalization strategies such as offshoring in response to the particular home country conditions.

The purpose of our study is to start addressing these important gaps. We ask: (1) How does home country labor protection affect firm offshoring? (2) Which boundary conditions will shape the relationship between home country labor protection and firm offshoring? We highlight the role of labor protection because stringent labor protection within the home country may hinder firm operational efficiency and effectiveness. When home country labor protection may lead to institutional challenges for domestic operations, we find that firms operating within home countries characterized by heavy labor protection may actively consider offshoring. Drawing on the home country literature (Cuervo-Cazurra & Ramamurti, 2014, 2017; Cuervo-Cazurra et al., 2015; Estrin et al., 2016; Hoskisson et al., 2013), we argue that firms headquartered or located in home countries characterized by relatively heavy labor protection are more inclined to undertake offshoring. This argument is also consistent with the varieties of capitalism (VOC) literature, which suggests that labor is an important actor within the home country (Hall & Soskice, 2001; Schneider, Schulze-Bentrop, & Paunescu, 2010).

Building on this baseline prediction, we also examine the boundary conditions that may moderate this proposed effect including labor

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https://doi.org/10.1016/j.jwb.2018.03.007
Received 27 January 2017; Received in revised form 10 March 2018; Accepted 22 March 2018

productivity and employee stock ownership. Results based on a sample of firms in five developed countries' information technology industry (Britain, France, Germany, Japan, and the United States) from 1990 to 2010 provide support for these arguments. These findings suggest that stringent home country labor protection can significantly motivate firms to undertake offshoring.

Our contributions are twofold. First, our study contributes to the home country literature (Cuervo-Cazurra et al., 2015; Hoskisson et al., 2013; Xia, Ma, Lu, & Yiu, 2014). Researchers contend that home countries may provide essential resources and assets, but can also create difficulties that hinder business operations. When faced with these challenges firms may seek opportunities elsewhere, often abroad (Cuervo-Cazurra & Ramamurti, 2014, 2017; Luo & Wang, 2012; Peng et al., 2008; Yamakawa, Peng, & Deeds, 2008). Although this insight has been proposed, most studies examine firms operating within emerging markets so that whether or not firms in developed countries have similar strategies is not well-understood (for an exception, see Witt & Lewin, 2007). We propose that firms based in developed countries may opt to reduce their exposure to the home country environment via offshoring. Specifically, offshoring can be viewed as a *partial* exit strategy for responding to potential constraints within the home country.

Second, our findings also have implications for both the VOC literature (Carney, Gedajlovic, & Yang, 2009; Hall & Soskice, 2001; Jackson & Deeg, 2008) and the offshoring literature (Contractor, Kumar, Kunda, & Pedersen, 2010; Doh, Bunyaratavej, & Hahn, 2009). On the one hand, whereas the VOC literature notes that labor plays different roles in different countries (Aguilera & Jackson, 2003, 2010; Van Essen, Oosterhout, & Heugens, 2013), few studies examine how firms respond to labor protection within their home countries. Our paper adds to this literature by considering offshoring as a viable response. On the other hand, while offshoring has received considerable scholarly attention (Contractor et al., 2010; Rodriguez & Nieto, 2016), prior studies largely emphasize host country factors rather than home country conditions. We endeavor to make and substantiate the case that home country context may be an important determinant for firm offshoring.

2. Theoretical background

2.1. Home country context and firm internationalization

The importance of home country context has long been discussed in the literature. Resources such as technology, capital, and labor acquired at home base can be useful for operating abroad (Porter, 1990). Hoskisson et al. (2013) contend that "a country's endowed factor markets significantly determine its economic opportunity set" (p. 1297). Marano et al. (2016) also maintain that home countries "play a crucial role in firms' ability to develop and maintain their competitive advantage at home" (p. 1077). At the same time scholars suggest that the home country effect may differ between emerging markets and developed countries. Since emerging markets are often less developed in terms of capital, product, and labor markets (Khanna & Palepu, 1997), firms based in these countries may not be able to maintain competitive advantage. In order to overcome such a disadvantage, firms operating within emerging markets may be more active in entering global markets (Peng, 2012).

Prior research shows that EMNEs may leverage the assets and resources that they can procure from the home country as a "springboard" to facilitate their foreign operations (Luo & Tung, 2007). Similarly, firms that regard home country operations as more costly are more inclined to engage in FDI (Cuervo-Cazurra et al., 2015; Luo & Wang, 2012; Xia et al., 2014; Yamakawa et al., 2008). Since home country operations are characterized by "rising transaction costs associated with continuing uncertainty" (Luo & Wang, 2012: 249), firms operating within emerging markets may be inclined to undertake FDI (Cuervo-Cazurra et al., 2015; Luo & Wang, 2012; Peng, 2012; Yamakawa et al., 2008).

However, studies on the home country effect largely focus on firms operating within emerging markets, while whether or not firms based in developed countries may behave similarly is less clear—a challenge that we take up. We contend that firms operating within relatively developed countries may encounter challenges when home country labor protection is stringent. These firms may accordingly use offshoring as a way to streamline their domestic operations. Following Manning, Massini, and Lewin (2008), we define offshoring as "the process of sourcing any business task, process, or function supporting domestic operations from abroad" (p. 35). Since offshoring is "a specific manifestation of *firm internationalization*" (Schmeisser, 2013: 390), the use of offshoring in this article specifically refers to "offshore outsourcing."

2.2. Labor protection in a world with varying capitalism

The level of labor protection is not the same across different countries (OECD, 2004). Countries impose different rules on labor, including the conditions for hiring and firing employees, the maximum number of working hours per week, and minimum wages. These arrangements are designed to provide social protection for workers (Botero, Djankov, La Porta, Lopez-De-Silanes, & Shleifer, 2004; Ochel, 2009). Botero et al. (2004) argue that "every country in the world has established a complex system of laws and institutions intended to protect the interests of workers" (p. 1339). For example, a typical employee who has worked for four to five years at a firm is entitled to one and a half months of severance pay in Japan, only half a month of severance pay in Britain, and zero severance pay in the United States. Similarly, employers can only fire workers in France and Germany with an advance notice period of seven to eight months, but in the United States this notice period is much shorter.

According to the VOC literature, these varying levels of labor protection reflect countries' different institutional and social arrangements (Crouch & Streek, 1997; Hall & Soskice, 1991; Whitley, 1999). Two points can be highlighted. First, when studying home country differences it is imperative to consider other actors in addition to firms per se, including the financial system, education system, and industrial relations (Aguilera & Jackson, 2003; Capron & Guillen, 2009). For example, as the education system provides the foundation for employees' knowledge and skills, a country's education and training system cannot be overlooked. Hall and Gingerich (2009) contend that "in order to prosper, firms must engage with other actors in multiple spheres of the political economy" (p. 452). Countries can accordingly be conceived as "systems of interconnected systems" (OECD, 1999: 23).

Second, key actors in a country such as labor may "have a diverse set of socially constituted identities and interests" (Aguilera & Jackson, 2010: 492). The VOC literature suggests two distinctive coordination methods: the liberal market economy (LME) versus the coordinated market economy (CME). In LMEs such as Britain and the United States the relationships among actors within a country are more characterized by arm's-length exchanges where the price signal is the primary mechanism for actors to determine their behaviors. In contrast, in CMEs such as France and Germany, actors' decisions and behaviors are more guided by non-market relationships rather than price. As these relationships place less emphasis on short-run gains and losses, actors within CMEs tend to have a shared view of their prospects and will behave accordingly. For example, if firms do not perform well financially in an LME, they are unlikely to effectively raise capital from the market. In contrast, financial actors (e.g., banks) within a CME tend to be more patient and embedded such that they are willing to provide long-term capital (Aguilera & Jackson, 2010: 527).

The focus of this paper is labor protection within the home country. We opt to highlight labor because it represents a critical stakeholder of firms (Aguilera & Jackson, 2003, 2010). When a country's institutional