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Do I stay or do I go? Sub-national drivers for post-entry subsidiary development

Agnieszka Chidlow [a,*], Christine Holmström-Lind [b], Ulf Holm [b], Steve Tallman [c]

[a] Manchester Metropolitan University, United Kingdom
[b] Uppsala University, Sweden
[c] University of Richmond, United States

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ABSTRACT

The impact of location-specific factors on a multinational company's activities has long been investigated by international business scholars. However, studies have focused their attention on the pre-entry location decisions of foreign subsidiaries, rather than the post-entry decision of relocation or development in place. Building on the existing international business research that relates to initial strategies this work aims to fill in the current gap in the literature by offering a novel understanding of the importance of location-specific factors for the post-entry development of a multinational company's subsidiaries within the sub-national regional context. Using on-line survey data and a discrete-choice model of 91 foreign subsidiaries in Poland, the results show that knowledge-seeking factors are the main drivers for the post-entry subsidiary development in the Mazowieckie sub-national region, while efficiency-seeking factors drive location to in other sub-national regions of Poland. The findings also show that subsidiaries are indifferent to regional location the subsidiary's post-entry development if agglomerations and infrastructure factors are important to multinational companies.

1. Introduction

Although multinational companies (MNCs), as the dominant actors in globalization (McCann, 2008), are inherently tied to differences across national locations, definitionally, practically and theoretically, our still-limited knowledge of the causes and consequences of the specifics of their location choices warrants further research (Beugelsdijk, McCann, & Mudambi, 2010; McCann & Acs, 2011). Scholars are coming to understand that the choice of location has become increasingly important, and increasingly tightly defined, for the success of MNC business models (Arregle, Beamish, & Hébert, 2009; Cantwell, 2009; Chidlow, Salciuviene, & Young, 2009; Dai, Eden, & Beamish, 2013; Goerzen, Asmussen, & Nielsen, 2013; Ma, Tong, & Fitza, 2013; Malhotra & Gaur, 2013; McCann & Mudambi, 2004; Piscitello, 2011). Studies in economic geography and development show that significant economic disparities occur within national borders, and therefore, tacit assumptions that locational considerations are homogenous within any one country are no longer tenable (Cantwell & Piscitello, 2005; Markusen & Venables, 1999; Parr, 2005; Porter, 1998; Scott & Storper, 2003). Tallman and Jenkins (2007, chap. 4) summarize by saying that while location characteristics matter more than ever to firms, the nation is no longer the lowest relevant level of analysis for location. Finally, the relative importance of local determinants of investment differs among foreign investors at the national level (Chung & Alcacer, 2002; Head & Mayer, 2004) and sub-national level (Chidlow et al., 2009; Fallon & Cook, 2010; Hilbert & Voicu, 2010; Ma et al., 2013).

The rise of emerging markets, with their extreme disparities in levels of economic development among their different sub-national regions, has only made this situation more apparent. Studies of industrial districts or clusters that consist of local agglomerations of firms in closely related industries (Porter, 1998) and of "global cities" that concentrate innovative knowledge development in large urban areas (Scott & Storper, 2003) demonstrate conclusively that economic conditions facing businesses vary significantly across sub-national regions. Thus, a better understanding of the role of sub-national locational characteristics on the location choices and subsequent re-investment and development of the subsidiaries of MNCs is more relevant today than ever, particularly in emerging market settings.

* Corresponding author. Tel.: +44 1612473863.
E-mail addresses: a.chidlow@mmu.ac.uk (A. Chidlow), Christine.holmstrom_lind@fek.uu.se (C. Holmström-Lind), ulf.holm@fek.uu.se (U. Holm), stallman@richmond.edu (S. Tallman).

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In studying specific locational advantages as determinants of the geographic localization of MNC subsidiaries, scholars have focused almost exclusively on *ex ante* observations of national-level initial entry choice determinants such as firm-specific resources, experience and learning, and country characteristics (Chen & Kwan, 2000; Kravis & Lipsey, 1982; Luo, Brennan, Liu, & Luo, 2008; Madhok, 1997). Much less research has considered the *ex post* outcomes of these choice decisions, such as the impact of the specific sub-national location advantages for the post-entry further development of foreign subsidiaries (Chang, Chung, & Moon, 2013; Uhlenbruck, 2004). However, we note that some 40% of foreign direct investment (FDI) income from emerging countries is reinvested in the host country for developing existing subsidiaries (UNCTAD, 2013), so an understanding of the determinants of reinvestment is as important to grasping the overall picture of FDI in sub-national regions as is understanding initial entry.

Particularly in emerging markets, initial entry decisions are made with limited information about the location and considerable uncertainty about how well the capabilities of the firm will actually fit with the demands and opportunities of the location (Tallman, 1992). Studies of *ex post* location performance (Chang et al., 2013) can therefore help us to understand the importance of fit for the future strategies of foreign subsidiaries. The decision of where to reinvest, whether to further develop the activities of a subsidiary in its original site or to shift to another sub-national region within a national market, is made with considerably more information and reduced uncertainty due to local host market experience, and might be considered to reflect a more informed, more economically rational, selection of location. This paper considers sub-national regional location characteristics in an emerging market with data on post-entry operational development to better understand the strategic drivers of reinvestment location. By doing so, this study hopes to initiate a debate about location specific factors in order to enrich our understand about the *place* of MNCs operations within a local context (Dai et al., 2013; Ma et al., 2013).

Based on a sub-national level dataset obtained from an on-line questionnaire and by integrating two broad strands of the literature, economic geography and international business, this paper provides an increased understanding of the link between pre-entry location choice and *ex post* outcomes of these decisions in terms of the fit of the location for the development of MNC subsidiaries at the sub-national level in the transition economy of Poland. The study analyzes factors in the business environment of sub-national regions in Poland that influence the post-entry development of foreign subsidiaries in five sub-national regions, where the central (Mazowieckie) sub-national region is compared to four other sub-national regions; the North-West, North-East, South-West and South-East of Poland. The identification of any differences in subsidiary development in these regions points to the sensitivity of the location of businesses within a country to specific sub-national location conditions. Our study therefore contributes to a better understanding of the role that location plays for reinvestment and subsequent subsidiary development at a sub-national level of location (Chidlow et al., 2009; Fallon & Cook, 2010; Hilbert & Voicu, 2010). This is, somehow, imperative in order to fully analyze the location of the MNC which in itself is "an increasingly important determinant of the scope, pattern, form and growth of multinational enterprises' activity" (Dunning, 2009: 26). In addition, this is also significant in order to enrich the current debate that is taking place within the international business literature which examines the concept of location from the headquarters resource allocation to subsidiaries (Dellestrand & Kappen, 2012), subsidiary's survival in host countries affected by political conflicts (Dai et al., 2013) and heterogeneity of subsidiary's performance (Ma et al., 2013).

The remainder of the study is structured as follows. The following two sections present the underlying literature and hypotheses formulation. Section 4 explains the method of data collection, the specification of the model and the variables used. Section 5 presents and discusses the results. Section 6 reveals concluding remarks.

2. Theoretical background

While there are numerous studies investigating the effect of FDI on the development of the MNC, hardly any studies have examined what drives subsidiary development after the initial foreign investment (Tallman & Li, 1996; Lu & Beamish, 2001). Although it could be expected that post-entry relocation and development of MNC subsidiaries would be of interest to IB scholars, rather little is known about this issue so far (Makino, Takehiko, & Chan, 2004).

Within the existing literature an array of explanations about firm development can be identified in which country effects (Caves, 1982), business strategy effects (Chandler, 1962), industry effects (Porter, 1998), firms' idiosyncratic capabilities (Barney, 1991; Penrose, 1959) and location effects (Dunning, 1988; Krugman, 1993) have been emphasized. In addition, research on subsidiary performance provides insights on the kind of factors that are crucial for the MNC subsidiaries in their specific locations (Christmann, Day, & Yip, 1999; Makino et al., 2004). For instance, Christmann et al. (1999) found that country factors were the most important determinants of performance, followed by industry structure, and subsidiary strategy. The implication, according to Christmann et al. (1999), is that subsidiary strategies are largely determined by factors outside the control of the MNC. Similarly, the subsidiary development literature (Birkinshaw & Hood, 1998), which has mainly been concerned with the evolution of subsidiaries over time, has found three major factors driving subsidiary development: the head-office assignment, the subsidiary's choices, and the local environment. The interactions among these variables would "determine the strategic role performed by the subsidiary and its evolutionary prospects, in an ongoing process of benchmarking and capability upgrading" (Tavares, 2001: 142).

One critique of the FDI literature as well as of the literature on subsidiary development is that most studies have approached the issue from either a firm-specific resource or corporate perspective (Assmussen, Pedersen, & Dhanaraj, 2009; Benito, Grøgaard, & Narula, 2003; Christmann et al., 1999). This implies that subsidiary development has been studied in terms of processes within the MNC's subsidiary or corporate headquarters intervention and assignments, with little concern for the locational context. In fact, several scholars have emphasized that the activities of an organization are dependent on the characteristics of the environment in which it takes place (Hannan & Freeman, 1977; Pfeffer & Salancik, 1978).

An "environmental determinism" perspective has been adopted in later research on MNC subsidiaries under the proposition that each subsidiary operates under a unique set of environmental conditions that determine its activities and behavior (Ghoshal & Bartlett, 1991; Ghoshal & Nohria, 1989; Rosenzweig & Nohria, 1995; Rosenzweig & Singh, 1991; Taggart, 1998), and to which it has to adapt in order to be effective (Birkinshaw & Hood, 1998).

While early research was typically focused on the role of the external environment in driving general organizational change (Porter, 1980; Tushman & Anderson, 1986), recent research has stressed the importance of the external environment for the development of multinational subsidiaries (Andersson, Forsgren, & Holm, 2002; Asmussen et al., 2009; Benito et al., 2003; Frost, Birkinshaw, & Ensign, 2002; Frost, 2001; Holm & Pedersen, 2000; Meyer et al., 2011). However, most of these studies have treated