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Advantage transfer on location choice and subsidiary performance☆

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ABSTRACT

Multinational enterprises (MNEs) conduct foreign investments by transferring advantages across borders. Such advantages have varying degrees of transferability. This study explores the effect of the location-boundedness of MNEs' advantage on international strategy and subsequent subsidiaries' performance. The empirical analysis draws on a combination of survey data and data from two databases. Using multiple sources avoids common method biases. Regression results show that marketing advantage has a higher degree of location-boundedness than production advantage does. Lower degrees of advantage's location-boundedness have an association with better subsidiary performance. This study extends the resource-based view into international context by examining what kinds of advantage have higher location-boundedness. The study also explores the barriers to international advantage transfer and their influences on MNE strategy.

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1. Introduction

Firms that own successful brands, superior production technology, and advanced managerial capabilities enjoy an inherent advantage when investing in other countries (Tseng, 2007). Multinational enterprises' (MNEs) advantage can transfer overseas to obtain economies of scale or scope that generate economic profitability and growth for the MNE (Buckley & Casson, 1998; Caves, 1971; Geringer, Tallman, & Olsen, 2000). This study draws on the resource-based view (RBV) that positions a firm as a collection of various advantages that are, to varying degrees, location-bounded. Advantage is location-bounded, in that some advantages can transfer across borders while others cannot (Boddewyn, Halbrich, & Perry, 1986; Rugman & Verbeke, 2001). Non-location-bound advantages relate to a low marginal cost of transferring advantages across borders. In contrast, location-bound advantages are not easy to duplicate in other regions and so entail substantial costs to develop (Rugman & Verbeke, 2001). Location-boundedness is not a dichotomy but rather a concept of degrees (Lo & Yu, 2008). This study identifies what kind of advantage is highly location-bounded and thus difficult to transfer across borders.

The environment highly affects MNEs' strategy implementation; this effect is particularly important when expanding to a host country (Geringer et al., 2000; Lu & Hebert, 2005). Firms require flexible systems of resource allocation to respond quickly to changes in their environment (Buckley & Casson, 1998). If MNEs' resources are location specific, these firms need to seek substitute resources in the host countries (e.g., local knowledge and local brands) (Delios & Beamish, 1999). Firms must select countries with adequate resources to compensate for MNEs' location-specific resources. The degree to which MNEs employ location-boundedness of advantages affects international strategies. This study posits that an MNE's strategy varies between overseas and domestic operations when an advantage is highly location-bounded. The literature lacks clarity about how the location-boundedness of advantage shapes MNEs' location strategy regarding foreign expansion. This study aims to understand how location-boundedness of advantage affects MNEs' location choice.

According to the RBV, firms with a unique competitive advantage can acquire greater economic rents (Barney, 1991), which in turn improve performance (Delios & Beamish, 1999). This study extends the RBV perspective on advantage into the international context and provides insights on barriers to advantage transfer. Advantages are obstacles to transfers between locations and are not applicable in different locations (Casson, Dark, & Gulamhussen, 2009). Non-location-bound advantages can stimulate investment performance through transfer across borders. Conversely, location-bound advantages represent limitations to successful investment in the performance of MNEs' overseas subsidiaries. Thus, this study also examines the effect of advantage's location-boundedness on the performance of MNEs' subsidiaries.

Despite location-bound advantage's acceptance in theory and practice, few empirical studies exist. This study follows previous work (Hu, 1995; Rugman & Verbeke, 2001) to fill this research gap and extends the effect of location-boundedness to MNEs' strategy or investment performance. The extent to which an advantage successfully transfers shapes a firm's strategic behavior (Lo, Mahoney, & Tan, 2011). When

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conducting foreign investment, MNEs that do not understand the difficulties of advantage transfer adopt strategies that lead to foreign investment failure. Thus, this research not only encourages international business research but also serves as a reference for MNEs' considering future overseas investments.

The study has the following structure. Section 2 presents the literature review and hypotheses, Section 3 explains the research design and methods, Section 4 discusses the findings, and Section 5 presents the discussion and conclusions.

2. Literature review and hypotheses

2.1. Location-boundedness of advantage

Each type of advantage or knowledge leads to different degrees of international transfer (Banalieva & Dhanaraj, 2013). Production resources have a lower transfer cost than marketing resources (Li, Goerzen, & Verbeke, 2006). Production knowledge is easier to transfer than marketing knowledge because production resources are easy to move while marketing resources depend on local situations and interact with local factors (e.g., consumers and channels) (Caves, 1971). Therefore, advantages have different degrees of location-boundedness.

In terms of the value chain, marketing internationalization should integrate with local needs to attract local consumers. Marketing advantage is highly location-bound and needs to interact with local conditions to create economic value (Boddewyn et al., 1986). Thus, marketing advantage transfer is difficult, implies higher costs, and has higher location-boundedness than production advantage because of production advantage's transfer facility and lower transfer costs.

H1. Production advantage has a lower degree of location-boundedness than marketing advantage does.

2.2. Location choice

2.2.1. Physical distance

When investing in foreign markets, MNEs not only exploit their original resources. MNEs also need the input of local resources in many circumstances (Madsen & Servais, 1997). Thus, MNEs with high location-bound advantage resort to local resources to transfer that advantage to the host country. Hence, MNEs need to choose an appropriate host country in which to invest. The potential to deploy resources or advantage in a foreign environment shapes MNEs' location choice for international investment (Grant, 2005). The degree of cultural, physical, and institutional distances between the home and host country hinders advantage transfer (Anand & Delios, 1997; Goerzen & Beamish, 2003). Thus, the location-boundedness of MNEs' advantages affects location choice.

Most MNEs (more than 80%) are regional rather than global (Rugman & Verbeke, 2005). Regional MNEs emerge because the environments within the same geographical area are more similar to one another than to those of other regions. Furthermore, the barriers to moving among countries within the same area are relatively lower (Oh & Contractor, 2014; Oh & Rugman, 2012). MNEs choose host countries within the same region because transfer costs are comparatively low. Physical distance degrades advantage; hence, investments in physically distant countries require more of the parent firm's financial and managerial resources (Graf & Mudambi, 2005; Li et al., 2006). Advantage's location-boundedness affects MNEs' location choice. MNEs with high location-bound advantage usually invest within the same region or choose less physically distant host countries.

H2a. Advantage's location-boundedness negatively affects the physical distance between an MNE's home and host country.

2.2.2. Cultural distance

The cultural similarity between the home and host country also affects advantage's transferability (Anand & Delios, 1997). Greater cultural distance impedes knowledge flow between partners; impairing a foreign parent firm's capability to acquire knowledge from local associates and domestic knowledge transfer (Wang & Schaan, 2008). When the tacitness, non-teachability, and non-codifiability constitute the highest degree of advantage's location-boundedness, MNEs usually choose culturally similar host countries. Cultural similarity can eliminate certain gaps or potential misunderstandings in location-bound advantage transfer between the parent firm and the overseas subsidiaries. Thus, MNEs' with high location-bound advantages usually choose the lower cultural distance host country as the target investment location.

H2b. Advantage's location-boundedness negatively affects the cultural distance between an MNE's home and host country.

2.2.3. Institutional distance

Decisions about foreign investment location should account not only for MNEs' motivations and capabilities but also for the institutional environment in potential host countries (Makino, Lau, & Yeh, 2002). Resource availability and the prevailing environmental conditions affect a firm's resource allocation, deployment, and development (Luo, 2003). The institutional context's similarity between the home and the host country affects advantage's transferability (Anand & Delios, 1997). MNE's advantage is easier to transfer when the similarity in domestic and foreign institutional contexts reduces managerial and adaptation costs and removes the need for local complementary assets.

Institutional differences between an MNE's domestic and host country increases entry cost, decreases operational benefits, and hampers the firm's ability to transfer advantage (Palich & Gomez-Mejia, 1999). A parent firm's failure to transfer management practice to the subsidiaries is largely attributable to institutional distance (Kostova, 1999). Thus, MNEs with a lower location-bound advantage can choose more freely the host countries in which to invest. Conversely, MNEs with a higher location-bound advantage usually choose host countries with smaller institutional distance from the home country to enhance advantage transfer.

H2c. Advantage's location-boundedness negatively affects the institutional distance between an MNE's home and host country.

2.3. Subsidiary performance

Traditional strategic management theories notice that a firm's resources or advantage influences strategy deployment (Wernerfelt, 1984). RBV further argues that the characteristics of internal resources affect the firm's strategy and performance. Thus, location-boundedness of advantage influences MNEs' investment performance. MNEs should have advantage or monopolistic resources (e.g., patents, information, managerial skills) that their local competitors lack to overcome the additional managerial costs in host countries (e.g., political hazard) and foreignness liability (Hymer, 1976). Firm-specific assets, when transferred to overseas can become foreign subsidiaries' competitive advantage (Birkinshaw & Hood, 1998; Isobe, Makino, and Montgomery, 2000). By transferring advantage, MNEs can develop foreign market opportunities (Tallman, 1992) or improve operations performance (Isobe et al., 2000).

Previous research shows that a parent firm's advantage affects the subsidiaries' performance (Isobe et al., 2000; Tallman, 1992). Nevertheless, an advantage's effect on subsidiary performance relies not only on MNE's advantage ownership but also on this advantage's degree of location-boundedness. In the international context, the parent firm's advantage may be unable to influence the subsidiaries' performance in different territories. A parent firm's advantage with a low location-

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