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Migrants and multinational firms: The role of institutional affinity and connectedness in FDI

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A R T I C L E I N F O

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A B S T R A C T

We examine how, and to what extent, migrants in a host country attract foreign direct investment (FDI) from firms based in their country of origin (CO). Introducing the notion of *institutional affinity*, we argue that increased *institutional affinity* and increased *connectedness* of institutional environments of migrants' CO and country of residence, make a location attractive to CO firms. Empirical analysis of FDI and migration panel data shows that in addition to the traditional factors influencing FDI patterns, there is a collective migrant effect on FDI, and this effect is statistically significant and economically meaningful for migrants from developing countries.

1. Introduction

The Department of Economic and Social Affairs at the United Nations estimates that 258 million people are living outside their country of birth worldwide as of 2017, up from 220 million in 2010 and 173 million in 2000 (UnitedNations, 2017). High-income countries host approximately two-thirds of all foreign-born population. As of 2017, 64% of all foreign-born population worldwide—165 million people—-lived in high-income countries (UnitedNations, 2017). The increased number of migrants (aka persons born in one country, but living permanently in another) and non-immigrants (or transient migrants as we call them) in the firms of many developed countries have prompted scholars to examine the effect of migration on the cross-border firm activities at micro (Foley & Kerr, 2012; Hernandez, 2014; Kerr, 2008; Shukla & Cantwell, 2016; Zaheer, Lamin, & Subramani, 2009) and macro levels (Buch, Kleinert, & Toubal, 2006; Javorcik, Özden, Spatareanu, & Neagu, 2011; Kugler & Rapoport, 2005).

From a global strategy perspective, migrants can be assets for firms seeking to expand overseas, as their idiosyncratic knowledge and prior home country experience (Shukla & Cantwell, 2016) can reduce the need for learning through operational experience in a foreign location (Johanson & Vahlne, 1977). So far, studies that have specifically examined the migration-foreign direct investment (FDI) link have emphasized the knowledge carrier channel as the mechanism by which migrants influence FDI activities between their country of origin (CO) and country of residence (CR). This stream of literature has ignored the notion that over time migrants also bring about *changes in the institutional environment* of a location, which makes the location *less foreign* and *more attractive* for investing firms. Focusing on this locational aspect, in this study, we seek an answer to the following question—How and to what extent do foreign-born workers in a host country exert gravitational pull on the inward FDI activities of firms from their CO? We view the institutional environment as one that "includes political institutions such as the regime type, the national structure of policy-making and the judicial system, economic institutions such as the structure of the national factor markets and the terms of access to international factors of production and socio-cultural factors such as informal norms, customs, mores and religions" (Mudambi & Navarra, 2002), as well as the social, economic, educational, and legal organizations that are the creators and gatekeepers of institutions in the context of a country.

To seek an answer to our research question, we draw on North's theory of institutional change (1990, 1991) and Granovetter's notion of personal ties (1973, 1985) to propose a novel conceptual framework that provides a cohesive conceptualization of the migration –FDI relationship and elaborates on the mechanisms that influence this relationship. Using migrant roles as an anchor for this framework, we identify two roles: (1) Migrants as creators of institutional affinity; (2) Migrants as connectors of institutional environments. This conceptual framework lays the groundwork for our hypotheses. Our main argument is that in addition to the traditional determinants of FDI (geographic proximity, economic development, political stability, quality of formal institutions, government effectiveness, rule of law, and linguistic proximity) established in the extant international business (IB) literature, increased concentration of migrants, *collectively* through their interactions and exchange in the social and economic realm help in

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creating an *institutional variety* in a location, which makes the location relatively *less foreign*; we call this locational institutional effect: *institutional affinity*. Reduced foreignness through mechanisms of trust, bounded solidarity (Portes & Sensenbrenner, 1993), homophily (McPherson, Smith-Lovin, & Cook, 2001), familiar business practices and rules in the location and increased connectedness through knowledge flows, positively affects resource investment in that location by migrants' CO firms. Thus, in this paper, we use a socio-economic lens to view the migration-FDI phenomenon. However, we do not lose sight of the fact that the firms we observe are for-profit firms and that they engage in FDI to create and capture wealth, whether the motive for FDI is to seek resources, markets, efficiency, knowledge, strategic assets or a combination of these.

We test the relationship between migration-related variables and inward FDI using panel data in the context of United States (U.S.) as the host country. To reduce endogeneity concerns, we use a deep lag of twelve years between prior migration variables and subsequent inward FDI stock. Therefore, we examine the effect of migration-related variables in 1980, 1990, and 2000 in the U.S. on FDI stock in 1992, 2002, and 2012 respectively. Our findings show that migrant-induced institutional change (in a developed host country) is a predictor of future inward FDI by firms from migrants' CO into migrants' CR for *developing country migrants*, thereby supporting our proposed hypotheses for institutional affinity, although only for developing countries. Our findings also reveal that the connectedness provided by migrants positively affects future inward FDI from migrants' CO to their CR for *both* developed and developing countries.

These findings suggest the importance of migrants especially in the cross-border strategies of emerging market firms. Migrant communities in international locations can raise the attractiveness of the location and can help reduce its foreignness, thus providing *locational advantages* to developing country firms seeking growth through internationalization. These locational advantages arising from increased institutional diversity accrue in the form of access to human resources with a shared cultural heritage, which allows for more effective sharing, interpretation, and application of knowledge about business practices, regulations, financial resources, and business connections. Advantages also arise for expatriate managers and decision-makers of CO firms who come to view the regions as familiar (relative to other foreign locations) as these regions have more in common with their CO environment, in the form of access to relevant religious, cultural, and economic organizations.

This study has several implications for the IB literature, and in particular for the theories of FDI and the literature on the host-country institutional environment. First, it establishes the role of migrant-induced institutional affinity, resulting from increased concentration of migrants from a CO in a given geographic location, as a driver of FDI for firms from that CO. Second, the conceptual framework that we develop here links migration with FDI through institutional change, cross-border institutional connectedness, and the level of CO development. More importantly, we distinguish between migration-induced *institutional variety in a host location* and migrant-induced *connectedness between* the CO and CR. By proposing two distinct effects in this respect, which are supported by the data, our framework provides the foundation for future empirical research in this domain. Third, the notion of institutional affinity introduced in this study has implications for the literature on institutional distance, which focuses on the *average* distance between the institutional environments of countries. Institutional affinity, our interpretation, concerns a more *focused effect* within the distribution of institutional characteristics in a CR; we elaborate on this idea in the discussion section. Lastly, this study uses an original dataset and introduces some novel measures of migrant activity for the migration-FDI literature.

2. Migration and International Business: Taking Stock

Beginning with the seminal work of Hymer (1960), and the path-breaking work of scholars such as Caves (1971) and Dunning (1980, 1988), there is now a huge literature that examines the determinants and effects of FDI activities of multinational firms (Agarwal, 1980; Blomstrom, Kokko, & Globerman, 2001; Blonigen, 2005; Caves, 1996; Dunning, 1993; Ghemawat, 2001; Kim & Aguilera, 2016; Nielsen, Asmussen, & Weatherall, 2017). FDI determinants, broadly speaking, fall into four major groups—cultural factors, institutional factors, economic factors, and geographic factors (Ghemawat, 2001). Several scholars have examined the effects of these factors on the cross-border economic activities of firms. Conceptualizing them as distances along the four dimensions, namely – cultural distance (Beugelsdijk, Kostova, Kunst, Spadafora, & van Essen, 2018; Kogut & Singh, 1988), economic distance (Tsang & Yip, 2007), geographic distance (Grosse & Trevino, 1996), and institutional distance (Kostova & Zaheer, 1999; Kostova, 1999; Xu & Shenkar, 2002), various scholars have examined how these distances influence the propensity of firms to engage in FDI. Evidence from a few recent studies suggests that foreign-born workers may help to bridge the cultural, economic, administrative, and technological distance between countries (Devane, 2006; Kerr, 2008; Madhavan & Iriyama, 2009; Oettl & Agrawal, 2008), thereby influencing the trade and investment flows between them.

Of the existing migration-FDI studies, only a handful examine the effect of migrants in a host country on the *inward* investment patterns of firms from migrants' CO in that host country. Buch et al. (2006) examine state-level data for Germany to find that states that have a large population from a foreign country attract higher stocks of FDI from that foreign country, suggesting that cultural linkages play a role in international economic relations. Foad (2012) examines the regional distribution of FDI and immigrants from 10 countries (primarily OECD countries) in the 50 U.S. states in a cross-sectional setting to find that immigrants attract FDI from their respective countries of origin. Hernandez (2014) argues that co-nationality increases both the motivation to engage in exchange as well as the efficiency of exchange due to homophily (McPherson et al., 2001).

Thus, prior studies emphasize one or both of the following two factors in influencing the relationship between migration and FDI: (1) the role of idiosyncratic knowledge held by foreign-born workers, and (2) the role of social ties, drawing on the relational governance perspective (Burt, 2000; Granovetter, 1985; Uzzi, 1997). The underlying assumption is that international economic activities carry higher transaction costs (Coase, 1937; Williamson, 1981) due to an increased liability of foreignness (Hymer, 1960; Zaheer, 1995), and migrants help to lower transaction costs through increased knowledge flows (Ellis, 2011). We argue in this paper that there is another factor that influences the migration-FDI relationship; this factor brings the *location* to the fore. We argue that increased concentration of migrants from a CO bring about *changes in the formal and informal institutional environment* of their CR, which in turn make the *location attractive* for investment to CO firms seeking to expand in foreign locations. We elaborate on this idea in the next section, where we present our conceptual framework for examining the migration-FDI relationship.

3. Theoretical framework and hypotheses development

To understand *how* the foreign-born population in a host country influences the FDI activities of CO multinational firms, we propose a role-based framework to explain the migration-FDI relationship. We identify two roles for the foreign-born persons: (1) as *creators* of institutional variety, and (2) as *connectors* of cross-border institutional environments, by virtue of which they can influence the investment activities of firms from their CO. As *creators* of institutional variety, migrants from a CO *collectively* help in reducing the liability of foreignness (Hymer, 1960; Zaheer, 1995) through the process of local