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Spatial mediation and moderated effect on FDI performance: Empirical study of Taiwanese firms in China (1999–2008)

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ABSTRACT

Taiwanese businesses exhibit a specific pattern when they enter into an uncertain territory, and tend to start off with a small amount of investments and explore markets by improvising strategies and tactics. This paper integrates theories concerning transaction costs and systems, and develops antecedent causes, and intervening and interference factors, by referring to the perspectives of economic geography. It is found that when faced with high uncertainties in emerging markets, multi-national corporations are highly concerned about institutional environments. Labor cost of different regions is an implicit indicator of the average wages that local companies are willing to pay. Companies that are willing to pay a high labor cost are less likely to face labor shortage, thus ensuring normal operation and better performance.

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1. Introduction

Since China embarked on a series of reforms and open-door policies in the 1990s, a large number of foreign businesses entered into the Chinese market. For Taiwanese businesses, the low labor cost in China is the key factor in cost reduction. In addition, the growing emerging markets in Asia, as well as the continuous development of the domestic market in China, has made China one of the most popular destinations for foreign direct investments. The eclectic paradigm is a theory in economics and is also known as the OLI-Model or OLI-Framework. Dunning (1998) added three more factors to the theory: (1) Ownership advantages, (2) Location advantages, and (3) Internalization advantages. The discussion on how local labor costs in China assist effective operations of multinational corporations (MNCs) has hence become a key issue for academia and practitioners.

1.1. Research motive

Taiwanese businesses exhibit a specific pattern when they enter into an uncertain territory, and tend to start off with a small amount of investments and explore markets by improvising strategies and tactics. Meanwhile, China is not an open society, and is known for complications and opaqueness in information and regulations.

Therefore, it is understandable that companies adopt conservative strategies (Boisot & Child, 1999). Based on Cooke (2009), this paper discusses the changes in the quantity and quality of human resources of MNCs in China, and observes the differences between China and the West in studies on joint-ventures with MNCs, regarding the integration of corporate strategies and human resources management (Gong, Shenkar, Luo, & Nyaw, 2005).

Most studies on the convergence of regional economies tend to ignore spatial factors and treat regions as isolated islands. This approach eliminates the possibility of interactions between regions (Mankiw, 1995; Quah, 1996). Highly-recognized studies, such as Baumol (1986), Barro and Sala-i-Martin (1995) and Mankiw, Romer, and Weil (1992), all overlook spatial factors. As a result, it becomes impossible to gauge whether spatial effects have material impact in the processes of regional economic growth. Hence, Rey and Montouri (1999) questioned the robustness of the empirical findings of those studies. In fact, it is necessary to incorporate geographic factors. Buckley and Ghauri (2004) suggested that international business (IB) is definitely a major issue concerning the effects of multinational enterprise (MNE) in the global economy, due to the results of strategic shifts. Spatial transaction costs and knowledge assets play a pivotal role in the process (Mudambi, 2008).

1.2. Research purpose

Past research on entry mode (or strategy) often discusses partner selection, but in fact, local economic growth and labor costs are

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also critical factors. For example, Cheng and Kwan (2000) studied the impact of market size, infrastructure construction, preferential tax rates, and salaries costs on direct overseas investment in China. This study selected Organizational Slack and Human Capital Relative Risk (HCRR) to discuss the performance of Taiwanese businesses after entering the mainland Chinese market. This can more accurately reflect the motivation of the Taiwanese businesses to enter the mainland Chinese market. Moreover, the entry mode may be affected by institutional factors; however, Cheng and Stough (2006) and Cheng and Kwan (2000) did not discuss the institutional factors affecting the entry mode.

In order to bridge this gap in literature, this research has three purposes: (1) to investigate the effect of HCRR in the spatial cluster and entry mode on the performance of joint ventures; (2) based on the Local Institutional Theory, to discuss what role infrastructure and labor costs have in organizational performance; (3) as China has a relatively closed environment and political instability; therefore, what is the effect of Organizational Slack when Taiwanese business enter the mainland Chinese market? To make up for deficiencies of the research tools of previous studies, this study especially considers the cross-level effect, and attempts to discuss the difference between this study and the international enterprise theory, as seen from the point view of spatiography, and develops a detailed framework for Taiwanese businesses to invest the mainland Chinese market.

2. Literature review

Most studies on regional economic convergence did not consider spatial elements, and regarded regions as isolated islands, while excluding the possibility of regional interaction (Mankiw, 1995; Quah, 1996). The classic works of Baumol (1986), Barro and Sala-i-Martin (1995), and Mankiw et al. (1992) did not consider spatial elements, thus, not providing an understanding on whether the spatial effect has significant influence in regional economic growth process. Rey and Montouri (1999) considered the robustness of empirical research conclusions as questionable.

However, past studies have suggested that location choices have a significant impact on the entry strategies of transnational corporations (Chen & Chen, 1998). From the cities' perspective, the urbanization of mainland China has developed for more than 10 years, and the economic momentum has shifted from the first-tier coastal cities to third-tier and fourth-tier inland cities as production element and labor costs become higher and higher, thus, many Taiwanese businesses have been shifted to inland cities. The International Institute for Urban Development, Beijing, estimated that China will continue to accelerate urbanization in the next 30 years (Nian, 2006).

Beugelsdijk, McCann, and Mudambi (2010) suggested that the major three schools focus on the issues surrounding companies and countries. In fact, traditional IB approaches do not delve into spatial issues associated with geographic locations. Hence, this paper concludes the following on the country level:

- 1) International trade theories: These theories consider companies as the synonym of market structures and to a large extent ignore many important organizational and spatial features and differences related to MNEs.
- 2) Economic geography and location study: One of the obvious shortcomings of traditional economic geography and location studies is ignorance in the complex multi-plant productions of different countries and spatial behavior of MNEs. Few discussions or analyses venture behind the description of key theories (McCann & Mudambi, 2004, 2005).

- 3) IB and strategic literature: Dunning (1998, 2009) conducted a precise analysis on multi-plant production and MNE activities, and indicated that with few exceptions, most scholars in strategy and IB often overlook location as a factor. In other words, studies on IB and strategies are relatively unsophisticated in spatial/geographic expressions (McCann & Mudambi, 2005).

However, a major change occurred about twenty years ago (McCann & Mudambi, 2004, 2005), when three scholars started a new era of possibilities from different domains: Scott (1988) in the traditional economic geography, Porter (1998) in strategy, and Krugman (1991) in trade theories. Their differing perspectives may affect analysis of the other two domains. In particular, the research scope of economic geography has rapidly expanded after long-term studies by Krugman (1991). There has been mushrooming perspectives developed from their literature, as scholars from different traditions offered their cooperation with other disciplines, and International economics attempted to incorporate the trade model of MNEs (Barba-Navaretti & Venables, 2004; Markusen, 2002).

2.1. Place, space, and organization vs. IB

Location choices were dealt with by connecting IB with OLI theories. Such connections examine the relationship between companies and countries. Therefore, by lowering the focus from the country level to the regional level, and incorporating the regional effects on time and space, it is necessary to factor in the perspectives of place, space, and organization (PSO).

From OLI to PSO, the research issues formed in the early 1990s developed in two directions. The IB perspective is based on how companies make their choices between exports and foreign direct investment (FDI). This extends to various FDI strategies, including horizontal options (the pursuit of markets) and vertical options (the pursuit of efficiency) (Aw & Lee, 2008). Subsequently, the addition of company-level heterogeneity into empirical models gained rapid popularity. Ghironi and Melitz (2005) provided insight into the change between trade goods and trade flows between countries. They used micro-level statistics on exports to examine the relationship among trading cost reductions, companies, and geographies (Bernard et al., 2003; Tybout, 2003). In sum, IB mainly focuses on the study of company heterogeneity and clustering.

IB and economic geography have interacted in PSO studies in recent years (Beugelsdijk et al., 2010). The six major research fields are clusters and entrepreneurship, spillovers, industry FDI and regional developments, outsourcing and innovation, organizational geography, experience learning, company clusters, and networks. This paper argues that in the context of spatial heterogeneity (rather than companies), the focus should be on (1) spillover effects; (2) clusters, networks, and companies; and (3) industry FDI and regional developments. These three domains can be viewed in combination with country/geography characteristics in the discussion of interactions between MNEs and spatial environments.

2.2. Local Institutional Theory

Allen and Kendall (1992) proposed that the regional strategies of MNEs can be viewed as alternatives to globalization. For example, MNEs from the United States are known for empowerment; whereas, MNEs from Japan centralize decisions and control at the parent companies. When MNEs from the United States seek to imitate the strategies of their Japanese peers, they often struggle and become stuck in the middle. This is how the eclectic regional strategy comes into play.

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