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Asset specificity and complementarity and MNE ownership strategies: The role of institutional distances

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ABSTRACT

This study integrates transaction cost economics and institutional theory to propose a contingency model of multinational enterprises' design of ownership control. We posit that asset specificity and complementarity influence the design of ownership control, which is further affected by the institutional environment. Furthermore, we argue that regulatory distance and normative distance display differentiating moderations on the main effects. Regulatory distance strengthens the positive effect of asset specificity on ownership control while normative distance enhances the negative effect of asset complementarity on ownership control.

1. Introduction

Ownership strategy (e.g., the choice between a wholly owned subsidiary and joint venture) is a kind of commonly used strategic control over a foreign subsidiary by multinational enterprises (MNE, Anderson & Gatignon, 1986; Hill, Hwang, & Kim, 1990). If aptly designed and implemented, it can have significant and long lasting performance implications (Brouthers, 2002; Brouthers, Brouthers, & Werner, 2003). Due to its highly strategic importance, hundreds of studies have addressed the determinants, processes and outcomes of the ownership design in the international context (Brouthers & Hennart, 2007; Canabal & White, 2008; Slangen & Hennart, 2008).

Two theoretical explanations have been greatly used to probe ownership strategy (Brouthers & Hennart, 2007). One is transaction cost economics (TCE) (Williamson, 1985), which propose two basic assumptions that managers have self-interest and bounded rationality. Preventing against opportunistic behavior may lead to increased transaction costs (i.e. monitoring cost), so it can be better for MNEs to design internalization strategies with higher levels of control to effectively address these problems (Anderson & Gatignon, 1986; Erramilli & Rao, 1993; Zhao, Luo, & Suh, 2004). MNEs' choice of entry mode highly depends on four key dimensions of transactions (i.e. transaction-specific assets, external uncertainty, internal uncertainty and free-riding potential) (Anderson & Gatignon, 1986). The other is institutional theory (North, 1990; Scott, 1995) which is a new sociological approach to provide fresh insights into internationalization studies. It asserts that MNEs are constrained by the host country's institutional environment (e.g., regulatory, normative and cognitive components) (Scott, 1995) and thus MNEs may respond to these constraints by leveraging ownership strategies (Gaur & Lu, 2007; Xu & Shenkar, 2002; Yiu & Makino, 2002).

The prescriptions offered by TCE and institutional theory are fundamentally different and have independent significant effects on organizational behavior because they have differentiating theoretical concerns. For example, TCE focus on efficiency considerations while institutional theory emphasizes legitimacy concerns (Martinez & Dacin, 1999; Roberts & Greenwood, 1997). It has been criticized for overemphasizing efficiency and self-interests without enough attention being given to the sociological view (Granovetter, 1985; Lu, 2002; Martinez & Dacin, 1999). It may not consider the complexities of the market environment. Alternatively, institutional theory is primarily concerned with firm conformity to gain legitimacy but has been criticized for ignoring a firm's self-interests (Powell, 1991; Scott, 1995). As Martinez and Dacin (1999) assert, TCE and institutional theory can be complementary to cope with both efficiency and legitimacy issues because neither of them has the capability to provide a full-scale explanation of organizational behavior. Brouthers and Hennart (2007) also offer a similar argument that one way to advance the field is to address the combinative effects of institutional factors with other decision-making criteria, such as TCE dimensions (Demirbag, Tatoglu, Glaister, & Zaim, 2010). Since there have been limited empirical studies to integrate

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these two theories, we aim to contribute by answering the following question to echo the summons: *How does the institutional environment influence the relationship between asset specificity, complementarity and ownership design*?

We focus on the regulatory and normative components of the institutional environment (Scott, 1995) and pay more attention to the difference of the two components between home and host countries, namely the regulatory distance and the normative distance (Kostova & Zaheer, 1999; Xu & Shenkar, 2002). While regulatory distance captures 'the difference between home and host countries in terms of the setting, monitoring and enforcement of rules' (Eden & Miller, 2004), normative distance refers to 'the differences in values, beliefs, norms, and assumptions about human nature and behaviors between two countries' (Kostova & Roth, 2002). Although some studies attempt to integrate TCE with institutional theory, they may merely focus on the regulatory component (e.g., Martinez & Dacin, 1999; Williamson, 1991), leaving more room for integrating TCE dimensions (e.g., asset specificity and asset complementarity) with the normative component (Yiu & Makino, 2002).

Moreover, we advance the literature by differentiating the influences between regulatory distance and normative distance.[3] Prior studies typically treat the effects of institutional distance as homogeneous (Bae & Salomon, 2010). For example, Xu, Pan, and Beamish (2004) predict that MNE will hold lower equity ownership when the regulatory and the normative distance are larger. Gaur and Lu (2007) also hypothesize the homogeneous moderating effects of the regulatory and normative distances on the ownership–survival relationships. However, regulatory distance and normative distance may have different functional mechanisms (Ionascu, Meyer, & Erstin, 2004), knowledge characteristics (Kostova & Zaheer, 1999), and boundary conditions (Bae & Salomon, 2010). Indeed, Estrin, Baghdasaryan, and Meyer (2009) have found that the effects of formal distance (measured in terms of regulations) and informal distance (measured in terms of culture) on MNE entry strategies are very different.

Thus, we propose that regulatory distance and normative distance may have varying influences on the effects of asset specificity and asset complementarity on ownership strategy. Specifically, we argue that while regulatory distance enhances the effect of asset specificity on ownership control because it causes MNEs to be concerned more about their specified assets, normative distance weakens the effect of asset specificity since it increases MNEs' tendency to create and capture more value from the assets. In a similar vein, regulatory distance weakens the effect of asset complementarity on ownership control because it increases MNEs' tendency to prevent the opportunism of local partners. In contrast, normative distance strengthens the effect of asset complementarity because it increases the need and usefulness of cooperation in creating value from complementary assets.

We summarize our propositions in the conceptual framework shown in Fig. 1 and organize this paper into three parts: first, we develop research hypotheses that combine TCE and institutional theory in the international context. Second, we describe our research method and test the hypotheses using a Chinese sample of firms that are doing business all over the world. Finally, we discuss the implications of the findings and provide directions for further research.

2. Theoretical development and hypotheses

2.1. Asset specificity and ownership design

Asset specificity is an investment that will lose value if the resource is adopted for other purposes (Williamson, 1996). Asset specificity is always related to the maladaptation or opportunism which is more likely

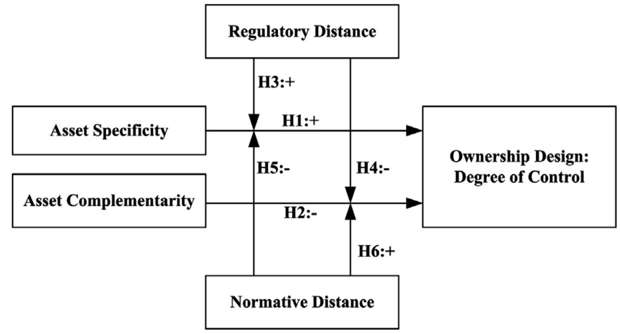

Fig. 1. A conceptual model on MNE ownership strategy.

to create contracting hazard (Hennart, 1988; Hill, 1990; Williamson, 1985). Based on TCE, as asset specificity increases, the transaction will likely be internalized because there might be greater hazards in the transaction. Especially when incomplete contractual arrangements or market competition cannot completely safeguard MNEs' specified assets from opportunism or improper use by a partner, the contracting hazards are more likely to happen when a firm enters a joint venture with a local partner (Lu, 2002; Mesquita & Brush, 2008) —when a firm enters a foreign market via a joint venture, the risk of hazard will increase as its resources will partially or entirely be exposed to the local partner.

Previous studies have mainly posited the positive relationship between asset specificity and the level of ownership (Anderson & Gatignon, 1986; Erramilli & Rao, 1993; Lu, 2002). For example, Anderson and Gatignon (1986) find that a MNE's degree of control reflected as ownership is positively related to the degree of asset specificity. Teece (1986) also claims that a higher level of asset specificity leads to a higher degree of integration and control. Delios and Henisz (2000) suggest that a MNE is better to choose ownership with a high level of control to prevent it from contracting hazards such as technological losses, or free-riding on brand name and reputation. Brouthers and Brouthers (2001) posit that as compared with joint ventures, firms with higher asset specificity prefer to choose WOS in both service and manufacturing industries. In the service industry, Erramilli and Rao (1993) also show that firms prefer to start with full-control mode in the foreign market, and gradually decrease the control rights as the asset specificity changes. Thus, we claim that when MNEs are holding the specified assets, in order to safeguard those assets from opportunism and maladaptation, they are more likely to design ownership with a higher level of control.

H1. Asset specificity increases the degree of control in the design of a MNE's ownership.

2.2. Asset complementarity and ownership design

In addition to the assets they own, firms are often faced with the need to acquire new resources when entering into a foreign market (Stopford & Wells, 1972). Complementary assets include tangible resources, such as equipment or labor resources which can be conveniently and directly obtained from markets and also the intangible resources, such as host country knowledge, local connections or other intellectual property which can be location specified.

The safeguarding of specific assets in an uncertain foreign market is a very important consideration for choice of foreign entry mode. However, the need to acquire new assets or complementary assets also has significant influence on firms' strategies (Mutinelli & Piscitello, 1998; Sachwald, 1995).

Actually, firms can gain complementary assets in a foreign market through many approaches such as acquisition by buying out the local

[3] Zaheer, Schomaker, and Nachum (2012) point out that distance constructs may suffer the flaw of 'distance without direction'. To keep consistent, we elaborate our hypotheses from the view of MNEs from more developed countries entering less developed countries.