International Business Review xxx (2016) xxx–xxx

Contents lists available at ScienceDirect

International Business Review

journal homepage: www.elsevier.com/locate/ibusrev

The moderating effect of bilateral investment treaty stringency on the relationship between political instability and subsidiary ownership choice

Christopher Williams[a,*], Tatiana Lukoianova (Vashchilko)[b], Candace A. Martinez[c]

[a] Durham University Business School, Mill Hill Lane, Durham, DH1 3LB, United Kingdom
[b] Haskayne School of Business, University of Calgary, Calgary, Alberta T2N 1N4, Canada
[c] University of Illinois at Urbana–Champaign, College of Business, Champaign, IL, USA

A R T I C L E I N F O

Article history:
Received 16 March 2015
Received in revised form 4 May 2016
Accepted 7 May 2016
Available online xxx

Keywords:
Political instability
Bilateral investment treaties (BITs)
Subsidiary ownership choice

A B S T R A C T

We investigate whether the degree to which a bilateral investment treaty (BIT) protects against expropriation (i.e., its "stringency") influences the international strategy of multinational enterprises (MNEs) as they invest in countries with varying levels of political instability. We draw on institutional logic and insights from political economics to hypothesize that BIT stringency will moderate the established positive relationship between host country political instability and minority ownership. Analysis of a sample of 289 foreign investments made by AEX-listed Dutch MNEs in 34 countries between 2004 and 2013 provides support: a more stringent BIT will encourage the MNE to choose a majority stake as political instability rises. Robustness tests provide further support for our argument. The results have both managerial and policy implications relating to the role that BIT stringency plays in determining MNE strategy.

© 2016 Elsevier Ltd. All rights reserved.

1. Introduction

Developed industrialized countries can use bilateral investment treaties (BITs) to protect the rights of their companies as they invest in uncertain markets. Developing and emerging countries, on the other hand, sign BITs in order to attract inward foreign direct investment (FDI) (Neumayer & Spess, 2005) and compete for a share of the world's FDI (Elkins, Guzman, & Simmons, 2006). Political uncertainty in host countries renders BITs useful as a source of information about the treatment of multinational enterprises (MNEs) and protection of their assets in such countries.

Scholars have argued that BITs can mitigate political instability by offering credible and enforceable international legal protection of foreign investors' rights (Raghavan, 1997; Rosendorff & Shin, 2015; Sornarajah, 2004; Wälde, 2005). There is a growing evidence that the *presence* of BITs encourages FDI and reduces the likelihood that host governments will engage in policies harmful to MNEs (e.g., Desbordes & Vicard, 2009; Elkins et al., 2006; Jandhyala and Weiner, 2014; Neumayer & Spess, 2005). However, research on this has yielded mixed and conflicting results (Kerner, 2009). Subsequently, scholars have begun to question how the *content* of BITs influences FDI across countries (Suarez Anzorena & Perry, 2010; Berger, Busse, Nunnenkamp & Roy, 2013).

Unfortunately, answers to the question of how the design and content of BITs influence MNE strategy have not yet been provided by international business (IB) research. There is little empirical evidence on how BIT provisions may be associated with MNE market entry strategy. Research on the institutional determinants of MNE strategy in the field of IB has mainly focused on other country-level institutional conditions that influence MNE internationalization decisions. Examples of these include: legal restrictions on FDI in the host country that influence use of joint ventures (Brouthers, 2002), how institutional progress in transition economies is related to MNEs choosing full ownership modes (Meyer, 2001), and the impact of institutional distance between home and host country on joint venture formation (Gaur & Lu, 2007). The IB literature on international strategy does not, by and

* Corresponding author.
E-mail addresses: chris.williams@durham.ac.uk (C. Williams), tatiana.vashchilko@ucalgary.ca (T. Lukoianova (Vashchilko)), cjmartnz@illinois.edu (C.A. Martinez).

http://dx.doi.org/10.1016/j.ibusrev.2016.05.002
0969-5931/© 2016 Elsevier Ltd. All rights reserved.

large, include treatment of international investment agreements (IIAs) such as BITs in theoretical or empirical work.[1] De Villa, Rajwani and Lawton (2015) recently noted the absence of focus on multi-levels of the political environment in market entry studies.

In this study, we address this research gap and build on recent research highlighting the *content* of IIAs as a determinant of FDI (Berger et al., 2013; Büthe & Milner, 2014; UNCTAD, 2014) *as opposed to the mere presence of such agreements.* More specifically, we investigate the impact of *BIT stringency* on ownership choice. We define BIT stringency as the degree to which the provisions within the BIT agreement legally protect signatory-country investors against expropriation. Some BITs are more protective of foreign investors than others in terms of types of potential expropriation (direct and/or indirect, i.e., creeping expropriation) (Wei, 2015), flexibility of investment dispute settlement mechanisms, compensation for expropriation, and other expropriation provisions (Lukoianova, 2013). BITs also differ in terms of whether they allow dispute resolution through the International Centre for the Settlement of Investment Disputes (ICSID) (Allee & Peinhardt, 2010).

BIT stringency is a critical aspect of the broader international institutional environment that guides subsidiary ownership choice, particularly in politically-unstable countries. This paper offers an argument explaining the impact of BIT stringency on subsidiary ownership choice under differing levels of political instability. By drawing on institutional theory and recent insights from international political economy (IPE) research, we hypothesize an indirect influence of BIT stringency on subsidiary ownership choice: at higher levels of political instability, a "stringency" effect comes into play that provides much needed "reassurance power" regarding international asset protection, inducing investing firms to choose majority ownership over – what would otherwise be – minority ownership. To date, there have been no empirical studies of the contingent relationship between BIT stringency, political instability, and ownership choice. Our empirical analysis is based on 289 foreign investments made by AEX-listed Dutch MNEs between 2004 and 2013 into 34 countries with which The Netherlands had a ratified BIT. Controlling for a range of firm-, country- and industry- factors, we find support for our hypothesis.

Our study contributes to the existing literature on MNE internationalization strategy in two important ways. First, we explain the linkages between the *design elements* (BIT stringency) of an institutional arrangement at the international level (as opposed to a domestic institutional arrangement within the borders of one country) and MNE international strategy. Secondly, we advance understanding of how international institutions and country-level conditions interact by examining the impact of BIT stringency on MNE choices as levels of political instability vary across host-country environments. To our knowledge, our research is the first study to examine the role of BIT stringency in this way.

2. Background and hypothesis development

2.1. Host country policy uncertainty and subsidiary ownership choice

Scholars have argued there is a strong impact of uncertainty in host-country policy on subsidiary ownership choice in the country; the greater the uncertainty, the more likely an investing MNE will choose minority ownership as opposed to a majority ownership or a wholly owned subsidiary (Xu & Shenkar, 2002). Why is this? A country exhibiting a strong regulatory institutional environment, that is, fundamental legal ground rules that are stable, transparent *and* enforced, inspires confidence in the country's investment environment, such that economic activities that occur within its borders can flourish (Holburn & Zelner, 2010; Li & Zahra, 2012). Contracts can be enforced; transgressors can be pursued in a functioning court of law. In such politically-stable environments, government leaders have a limited ability to make abrupt and discriminatory policy changes that might adversely influence MNE strategy (Wei, 2015). In such an environment, external uncertainty – exogenous to the firm – is diminished.

When it comes to more unstable countries – such as those in the developing world and at the transitional periphery (Wood & Demirbag, 2015) – the impact of politics is more prominent. Political systems represent agents of institutional change in such countries (Henisz, 2002; Peng, 2003). When political instability arises, the potential exists for an unexpected change in the set of external forces that influence the MNE's investment in the country. As noted by Eden and Molot (2002), MNEs "actively attempt to shape government policies toward their industry" (Eden & Molot, 2002: 367). Instability in the political environment of a host country increases the likelihood of corresponding turmoil in this policy environment (Peng, 2003). In the presence of political instability, an investing MNE then will face a greater challenge in its ongoing bargaining discussion with numerous actors in the host country (Henisz & Zelner, 2005) as it prepares for investment. As MNEs engage in bargaining in this type of environment, political actors can "overturn, alter or re-interpret emerging institutions" (Henisz & Zelner, 2005: 373) at short notice. Government actions also can attempt to alter the distribution of wealth by means of nationalization, taxation, and money supply regulations. In this context, bargaining becomes troublesome because politicians can be "ambivalent, and sometimes contradictory, in driving economic reform agendas" (Wood & Demirbag, 2015: 1). In other words, the lack of checks and balances associated with political instability will reinforce the possibility that regulations themselves will be hard to predict and invested assets harder to protect. Abrupt changes in the political environment can cause potential financial loss for firms, as well (Henisz, 2000). Research has highlighted the vulnerability of MNEs in these circumstances (Czinkota, Knight, Liesch, & Steen, 2010).

Choosing minority ownership can alleviate these concerns by improving the MNE's ability to learn about emerging (and changing) institutions while limiting commitment (Pak & Park, 2004; Xu & Shenkar, 2002). Indeed, several studies have reached similar conclusions on the relationship between political uncertainty and subsidiary ownership choice (Brouthers, 2002; Demirbag, Glaister, & Tatoglu, 2007; Gatignon & Anderson, 1988).

2.2. Content of bilateral investment treaties

We argue that this relationship between political instability and subsidiary ownership choice will be moderated by the content of any international investment agreement (IIA) – such as a BIT – between the home and host country, in particular, the content associated with the protection of international investments. We focus on BITs as they are the most prevalent form of bi-lateral investment agreement although our argument may apply also to other forms of IIA such as investment provisions in regional economic institutions. According to the United Nations Conference on Trade and Development (UNCTAD), there are currently 2279 ratified BITs in force, compared to 280 other forms of IIA between countries (UNCTAD, 2015). It has recently been argued that more autocratic countries – with much to gain from FDI – will sign BITs to add credibility to investment promises they make to outside investors (Rosendorff & Shin, 2015). As noted by Wei (2015):

[1] One recent exception is Jandhyala and Weiner (2014), who demonstrate how MNEs place a higher value on foreign assets protected by international investment agreements than those that are not protected at an international level.

Please cite this article in press as: C. Williams, et al., The moderating effect of bilateral investment treaty stringency on the relationship between political instability and subsidiary ownership choice, International Business Review (2016), http://dx.doi.org/10.1016/j.ibusrev.2016.05.002

Download English Version:

https://daneshyari.com/en/article/5107040

Download Persian Version:

https://daneshyari.com/article/5107040

Daneshyari.com