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Institutional difference, organizational experience, and foreign affiliate performance: Evidence from Polish firms

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A B S T R A C T

We draw from the institutional economics and organizational learning theories to clarify two international business debates. The first debate involves how institutional distance affects foreign affiliate performance: some propose a negative and others a positive direct effect. We clarify this debate by differentiating between negative and positive institutional difference. The second debate involves how experience modifies this relationship: some propose a negative and others a positive moderating effect. We clarify this debate by differentiating between similar and dissimilar experience, creating four moderating effects: *Advantage of Challenge Anticipation*, *Advantage of Opportunity Anticipation*, *Disadvantage of Polymath Downgrading*, and *Disadvantage of Specialist Upgrading*.

1. Introduction

In this paper, we analyze the relationship between host-home institutional difference and foreign affiliate performance of infant multinationals from transition economies. Infant multinationals face particular challenges during their international expansion as their ability to deploy their constrained firm-specific advantages abroad depends on the level of institutional development in the host countries vis-à-vis that of their domestic market (Chan, Isobe, & Makino, 2008; Makino, Isobe, & Chan, 2004; Ramamurti, 2012). The magnitude of such host-home institutional differences—i.e., the degree to which the host country is more advanced (positive institutional difference) or less developed (negative institutional difference) than the home country—becomes particularly important for the affiliate performance of such infant multinationals. While much of the institutional economics literature has focused on the magnitude of host-home institutional distance (i.e., the degree to which countries differ), its direction (negative or positive) has been gaining research impetus as well (Aleksynska & Havrylchyk, 2013; Cuervo-Cazurra & Genc, 2011; Hernandez & Nieto, 2015; Zaheer, Shomaker, & Nachum, 2012, p. 25; Zaheer & Hernandez, 2011).

This has lead to mixed findings regarding the relationship between institutional distance and performance. Some propose that a larger institutional distance reduces firm performance because it increases uncertainty and transaction costs (e.g., Dow & Ferencikova, 2010; Ghemawat, 2001; Zaheer, 1995). Others counter that a larger institutional distance increases firm performance because it motivates firms to undertake more aggressive research for better strategic decision-making (e.g., Dikova, 2009; Evans & Mavondo, 2002; Nachum, Zaheer, & Gross, 2008). We aim to clarify this debate by distinguishing between negative and positive institutional difference and analyzing their divergent effects on affiliate performance of infant multinationals.

Additionally, we build on research noting that multinationals are not blank slates during their international expansion but draw from their organizational experience from prior host market entries (Carlsson, Nordegren, & Sjoholm, 2005; Gao, Pan, Lu, & Tao, 2008; Dadzie, Larimo, & Nguyen, 2014; Hansen & Gwozdz, 2015; Pattnaik, Choe, & Singh, 2015; Perkins, 2014). Organizational experience involves the "historical memory of routines" that firms replicate when faced with similar institutional conditions (Perkins, 2014). Organizational experience helps reduce uncertainty and transaction costs, attenuating the performance losses from larger institutional distance (Dikova, 2009; Luo & Peng, 1999). However,

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organizational experience can also further solidify the performance losses from a larger institutional distance because it creates an illusion of similarity and organizational inertia (Luo, 1999; O'Grady & Lane, 1996; Wu and Lin, 2010). We aim to clarify this debate by distinguishing between two types of organizational experience: similar experience (i.e., prior experience operating in institutional environments similar to that of the host country) and dissimilar experience (i.e., prior experience operating in institutional environments that differ from that of the host country). We propose that the two types of organizational experience have divergent modifying effects on the relationships between institutional difference and foreign affiliate performance. In so doing, we further answer the recent call that "[f]uture study could further delineate learning in order to provide a more comprehensive picture of how different types of learning contribute to EMNE subsidiary performance" (Liu, Gao, Lu, & Lioliou, 2016; p. 149).

We test our framework in the context of foreign affiliates of Polish infant multinationals.

Poland is a post-communist transition economy that still lags behind its advanced country counterparts in terms of infrastructure and factor market development (Hoskisson, Wright, Filatotchev & Peng, 2013). Post-communist transition economies are the countries in Central and Eastern Europe (CEE) that were once under central planning, which they later abandoned on their way toward free markets (Hoskisson, Eden, Lau, & Wright, 2000). Yet, Poland's status as a mid-range economy in terms of its overall economic development (Hoskisson et al., 2013) yields sufficient variation of host countries that are more or less developed than Poland. Poland is also a leading source of foreign direct investment (FDI) from CEE (UNCTD, 2015). Polish outward FDI is spread over a balanced portfolio of advanced and emerging markets owing to Poland's unique geographic location. Infant multinationals are firms from such markets that are still in their early stages of internationalization, so they tend to rely on their home country advantages more than on their firm-specific advantages (Ramamurti, 2010). As such, they have products that are well-recognized domestically but are yet to be established internationally.

We use a mixed-method research design for a richer understanding of the hypothesized relationships. We aim to contribute to the institutional economics and organizational learning theories. We extend institutional economics research on the relationship between the magnitude of institutional distance and firm performance by explicitly analyzing the direction of institutional distance between Poland and the host country of the largest affiliate for each Polish multinational: positive vs. negative. We theorize that each has a divergent effect on foreign affiliate performance. We further extend organizational learning research focused on how experience modifies the relationship between institutional distance and performance by analyzing the modifying effects of two types of experience (similar vs. dissimilar) on the institutional difference (negative and positive) −foreign affiliate performance relationships. We theorize four moderation effects: *Advantage of Challenge Anticipation*, *Advantage of Opportunity Anticipation*, *Disadvantage of Polymath Downgrading*, or a *Disadvantage of Specialist Upgrading* for the infant multinationals.

2. Conceptual overview

We begin by reviewing the extant literature on institutional distance, experience, and foreign affiliate performance (Tables 1A–1C). Our overview is not intended to be exhaustive, but to highlight the key papers, which serve as the theoretical basis for our study.

First, the relationship between institutional distance and foreign affiliate performance has been debated in the institutional economics literature (for an overview, see Chari & Shaikh, 2016; Zaheer & Hernandez, 2011). As summarized in Table 1A, much of this literature has found that a larger host-home institutional distance reduces firm performance due to higher uncertainty and transaction costs (Ghemawat, 2001; Zaheer et al., 2012; Zaheer, 1995). Others have proposed that a larger institutional distance may, instead, have a positive impact on firm performance because entering more psychically distant markets motivates firms to undertake more aggressive research and improve their strategic decision-making (Dikova, 2009; Evans & Mavondo, 2002; Nachum et al., 2008). Some recent advances in the literature have begun

Table 1A
Overview of research on institutional distance and foreign affiliate performance.

Author (s)	Theoretical approach	Sample and Data	Methods	Operationalization of distance/ experience	Operationalization of performance	Key Findings
Ando (2014)	institutional theory (*legitimacy in an institutional environment*)	panel data on 4662 foreign subsidiaries of Japanese MNEs in 62 countries (*secondary*)	fixed-effects panel regressions	institutional distance: six dimensions of World Bank's governance indicators; international experience: log of total operation years of all subsidiaries of a parent	labor productivity (*subsidiary sales divided by the number of employees*)	institutional distance reduces the positive effect of using host-country nationals on subsidiary performance; positive effect of international experience is only significant in subgroups
Gaur, Delios, and Singh (2007)	institutional theory (*familiarity of institutional environment*)	panel data on 12 997 foreign subsidiaries of 2 952 Japanese MNEs in 48 countries (*secondary*)	binary logistic regressions and OLS regressions	institutional distance: 14 indicators for regulative and normative distance based on World Competitiveness Yearbook and Euromoney; cultural distance based on Hofstede's 4 original dimensions	labor productivity (*subsidiary sales divided by the number of employees*)	regulative and cultural distances reduce the positive effect of using host-country nationals on subsidiary performance
Pattnaik (2007)	institutional theory (*quality of institutional environment*)	235 subsidiaries of 89 Korean MNEs in 30 countries (*secondary*)	multiple regression analysis	institutional distance: product market quality, capital market quality, labor market quality, labor market regulatory quality, political and social quality, degree of openness; experience: number of foreign countries entered	ROA (*net income over assets of a foreign subsidiary*)	negative effect of institutional distance, non-significant positive effect of experience
Pattnaik et al. (2015)	institutional theory (*quality of institutional environment*)	318 subsidiaries of 146 Korean firms in 28 countries (*secondary*)	Multiple regression analysis	institutional distance: product market quality, capital market quality, labor market quality, labor market regulatory quality, political and social quality; experience: number of foreign countries entered	ROA (*net income over assets of a foreign affiliate*)	negative effect of institutional distance, positive effect of experience on foreign affiliate performance