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Subnational institutions, political capital, and the internationalization of entrepreneurial firms in emerging economies

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ABSTRACT

This study advances the institution-based view of strategy by integrating it with firm-specific capability considerations. In particular, we investigate the integrative influence of subnational-level home country institutional environments and firm-level political capital, as an important way to seek resources, on emerging economy entrepreneurial firms' internationalization. With data from Chinese entrepreneurial firms, we find that the development of subnational institutional environments in the home country is related to firms' degree of internationalization. Furthermore, while political capital with low-level governments enhances the effect of subnational institutions on internationalization, political capital with high levels of government has no such moderation effect. Theoretical and empirical contributions and implications are discussed.

1. Introduction

How do external factors such as location and regional institutions impact entrepreneurial firms' internationalization strategies? Drawing on a long line of research on the role of exogenous factors such as institutions and geography on economic activity (Acemoglu, 2003; McCloskey, 2013; Rodrik & Subramanian, 2003) and grounded in the industry-based view, extant research in international business (IB) has investigated the influence of host country environments on firm strategies in a range of settings (e.g., Ahlstrom, Levitas, Hitt, Dacin, & Zhu, 2014; Dikova, Jaklič, Burger, & Kunčič, 2016; Hitt, Li, & Xu, 2016). Other recent work shows how home country environments, in particular both formal and informal country-level institutional environments, exert important influences on firms' actions regarding internationalization and other outcomes (Meyer, Estrin, Bhaumik, & Peng, 2009; Wan & Hoskisson, 2003; Yamakawa, Peng, & Deeds, 2008).

Less is known, however, about the influence of subnational institutions in the home country on firms' internationalization strategies. This gap is important because there is an uneven distribution of institutional development across subnational regions in many countries, including large emerging countries (Chan, Makino, & Isobe, 2010a). In addition, other differentiating factors, such as different subcultures and dialects, exist (Dow, Cuypers, & Ertug, 2016; Gong, Chow, & Ahlstrom, 2011; Redfern & Crawford, 2010). Relatedly, the strategic management and international business literature streams have started to shed more light on the effects of subnational regions on firm performance (Chan et al., 2010a; Ma, Tong, & Fitza, 2013). Thus, the main purpose of this study is to join these research streams by examining how within home-country variations of institutions influence firms' internationalization strategies.

This study focuses on the internationalization strategies of emerging economy entrepreneurial firms. In particular, we argue that (1) well-established subnational institutional environments in emerging economies can have a positive effect on entrepreneurial firms' internationalization and (2) such an effect is contingent on individual firms' resource-seeking strategies. We investigate the role of entrepreneurial firms' political capital, with both higher- and lower-level governments in the home country (Ahlstrom, Bruton & Lui, 2000; Lu & Ma, 2008), as an important resource-seeking strategy. This differentiation of political capital is consistent with recent research showing that firms must deploy their networks in cohesive and coordinated ways to successfully execute globalization strategies (Hatani & McGaughey, 2013).

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This study tests several hypotheses using biennial-surveyed longitudinal data of a sample of 760 Chinese entrepreneurial firms from 2002 to 2006, a time period when Chinese firms were globalizing in increasing numbers. The substantive variation of within-country institutional environments, the critical role of the Chinese government in economic activities, the active deployment of political capital, and the increasing number of multinational corporations (MNCs) from China all provide an appropriate empirical context to test the research model proposed in this study (Ahlstrom, Young, Nair, & Law, 2003; Alon, Yeheskel, Lerner, & Zhang, 2013).

Several contributions to international business research and practice are offered in this study. First, we provide further evidence of the importance of a firm's geography for its strategic choice, particular the impact of subnational, more local institutions. Our study is consistent with a growing stream of research that explicitly recognizes the strategic role and implication of MNCs' home country geographic location and related regional factors (Poncet, 2005; Sölvell, 2015; Wan & Hoskisson, 2003; Yamakawa et al., 2008). This article aims to extend that work by demonstrating the presence and importance of subnational institutions and their impact on shaping the internationalization strategy of entrepreneurial firms embedded within the context. One contribution of this study therefore lies in integrating the international business literature with subnational geography studies.

Second, this study contributes to theory by extending the institution-based view of strategy (Peng, Sun, Pinkham, & Chen, 2009) to examine the interactive effect of subnational institution with firm-level strategy. Rather than treating firms as passive recipients of benefits from strong (and uniform) institutions, we view them as active participants trying to exploit advantages from their varied institutional environments in their home country, as is also noted in work on nonmarket strategies in IB (Doh, McGuire, & Ozaki, 2015).[1] Research has long argued that political capital facilitates the performance of firms in various ways (e.g., Ahlstrom, Bruton, & Yeh, 2008; Dunbar & Ahlstrom, 1995; Peng & Health, 1996). Specifically, we differentiate between political capital with various levels of government (Higgins, Young, & Levy, 2009; Li, He, Lam, & Yiu, 2012; Meyer & Peng, 2005). In particular, we contend that deployment of political capital with high-level governments aids entrepreneurial firms in securing resources from their institutional environments by enhancing their credibility and legitimacy (Ahlstrom et al., 2008), while political capital with lower level governments enhances firms' resource-seeking capability through acquisition of key institutional information. Thus, we offer a framework that accounts for both institutions in the home country and entrepreneurial firms' resource-seeking strategy.

Finally, studies in strategic management limit the effects of political capital to the strategic behavior in firms' domestic market, thus largely ignoring their effects in international markets (Faccio, 2010; Faccio, Masulis, & McConnell, 2006; Wu, 2011; You & Du, 2012). Given the limited international experience of emerging economy–based entrepreneurial firms, this article provides insights into how and to what extent they utilize political capital across borders, leading to a better understanding of their international strategies (Frynas, Mellahi, & Pigman, 2006).

2. Theory

2.1. An institution-based view of internationalization

Institutions are commonly recognized rules, both formal (e.g., regulations, laws) and informal (e.g., codes of conduct, norms), in a society (North, 1990). Scott (2013) defines institutions as the regulative, normative, and cognitive structures and activities that provide stability and meaning to social behavior. Regulative or legal aspects of institutions most commonly take the form of formal institutions—they guide organizational action by force or threat of legal sanctions—while normative and cognitive institutions generally take the form of informal institutions—they guide organizational actions stemming from social, professional, and cognitive-cultural aspects (Chao & Kumar, 2010; Scott, 2013). In this sense, institutions structure the economic, political, and social relationships in a society or country and thus determine the transaction and transformation costs of firms embedded within them (Chan et al., 2010a). Therefore, by treating institutions as independent variables, the institution-based view defines firms' strategic choices and performance as linked to the economic, political, and social institutions they confront (Meyer et al., 2009; Peng, Wang, & Yi, 2008; Yamakawa et al., 2008).

Scholars have documented the growing importance of formal and informal institutions as both constraints and facilitators to strategy across borders (Doh, Luthans, & Slocum, 2016; Hitt, Ahlstrom, Dacin, Levitas, & Svobodina, 2004). Propelled by research on emerging economies, an institution-based view has been influential in the study of internationalization (Holmes, Miller, Hitt, & Salmador, 2013; Yamakawa et al., 2008) and increasingly in entrepreneurship (Bruton, Ahlstrom, & Li, 2010). This is because emerging and developed economies can vary significantly in terms of institutional frameworks (Acemoglu & Johnson, 2005; Acemoglu & Robinson, 2013; Ahlstrom et al., 2003). Emerging economies are typically characterized by poorer governance and weaker and less efficient formal institutions (Cuervo-Cazurra & Genc, 2008; De Soto, 1989).

These profound differences in institutional frameworks have led scholars to pay more attention to how the institutional environment shapes MNCs' internationalization strategies and performance. For example, recent studies on institutional distance have found that distances on the regulative, normative, and cognitive dimensions of institutions between the host and home countries affect MNCs' strategies pertaining to host country selection, entry mode, and performance (e.g., Chao & Kumar, 2010; Schwens, Eiche, & Kabst, 2011; Xu & Shenkar, 2002). Another stream of research focuses on the home country institutional environment and shows that the level of institutional development in the home country may affect firms' tendency to internationalize as well as their subsequent performance (e.g., Wan & Hoskisson, 2003; Yamakawa et al., 2008). These two streams of literature agree that national-level institutional environments of either the home or host countries shape MNCs' internationalization strategies and performance.

Studies have also shown that an additional class of institutional environmental factors, that is, subnational institutions in home countries, has a statistically significant impact on a foreign subsidiary's choice of entry strategy and performance (e.g., Chan et al., 2010a; Ma et al., 2013; Meyer & Nguyen, 2005). Arguably, a subnational level allows for a more fine-grained analysis of regional differences, given that subnational regions in an emerging country can differ remarkably in the level of institutional development (Ma et al., 2013; Zhou, Delios, & Yang, 2002). Despite generally significant findings, this stream of studies has two limitations. First, little is still known about the role of home country subnational institutions in firms' internationalization

[1] Institutions are considered strong if they support the voluntary exchange underpinning an effective market mechanism (Meyer et al., 2009).