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How “space” and “place” influence subsidiary host country political embeddedness

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ABSTRACT

As a part of multinational corporations (MNCs), subsidiaries operate in distinct host countries and have to deal with their external context. Host country political embeddedness, in particular, helps subsidiaries to obtain knowledge and understanding of the regulatory and political context, and to get access to local networks. Moreover, they get some guidance and support from their headquarters. Distance between MNC home and host countries, however, alienates subsidiaries from the MNC and influences the extent of subsidiary host country political embeddedness. We suggest that the host country political and regulatory context moderates the effect of distance on subsidiary host country political embeddedness by reducing the need and/or value of headquarters support. Using a sample of 124 European manufacturing subsidiaries, we find that distance (space) and context (place) matter jointly: the impact of distance is stronger for subsidiaries that operate in host countries with low governance quality and low political stability in place.

1. Introduction

A multinational corporation’s (MNC) operations are internationally dispersed across different political, social, and regulatory contexts, where it faces a broad set of stakeholders. Political actors are an important part of this stakeholder network. They shape public policy and control resources, and can thus create or constrain opportunities for MNCs (Baron, 1995; Getz, 1997; Wan & Hillman, 2006). Therefore, MNCs have an incentive to interact with and influence policy makers in both developing and developed countries (Brewer, 1992; Choi et al., 2014; Luo, 2001; Murtha & Lenway, 1994; Rajwani & Liedong, 2015).

One important way in which MNCs can interact with and influence policy makers is by letting their subsidiaries become embedded in their local host country’s political networks. Subsidiary political embeddedness can be defined as the extent to which the subsidiary maintains linkages to local political actors such as governments, industry associations, and unions. From an institutional perspective, such linkages enable subsidiaries to acquire host country-specific and actor-specific knowledge, which they can in turn use to negotiate and actively influence their legitimacy (Doh, Lawton, & Rajwani, 2012; Dowling & Pfeffer, 1975; Henisz & Zelner, 2003; Hillman & Wan, 2005; Peng & Luo, 2000).

Scholars have made very valuable contributions to our understanding of why subsidiaries invest more or less into linkages with political actors. The antecedents of subsidiary political embeddedness have received considerable scholarly attention. For example, it has been shown that subsidiaries adapt their political embeddedness to the institutional context in the host country (Bonardi, Holburn, & Van den Bergh, 2006; De Figueiredo, 2009). Furthermore, subsidiaries adapt their political embeddedness to the MNC-internal context (Hillman & Wan, 2005; Kostova, Roth, & Dacin, 2008; Luo, 2003).

Nevertheless, we suggest that we need to revisit this issue for the following reasons. First, while studies have investigated an extensive range of country-level factors and their impact on political embeddedness, there are few studies that examine more fine-grained dimensions (Berry, Guillén, & Zhou, 2010; Jackson & Deeg, 2008). In particular, there is a need for integration of both the multifaceted nature of institutions and the role of distance as country-level factor in our studies of international business (Henisz & Swaminathan, 2008). Second, while a number of studies have claimed to examine the multifaceted impact of country-level factors on MNC subsidiaries, some of them have recently been criticized for mixing up effects (van Hoorn & Maseland, 2016). More specifically, studies in international business have often failed to distinguish between the effects of institutional distance and context.

To shed light on these issues, we build on institutional theory (e.g. Berry et al., 2010; Kostova et al., 2008), as well as recent international business and economic geography literature (e.g. Beugelsdijk, McCann, & Mudambi,

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2010). We investigate the independent and joint effects of country-level factors, namely the geographic and contextual distance between a subsidiary host and its headquarters' home country, and the host country context in terms of governance quality and political stability, on political embeddedness. In line with economic geography literature, we will refer to these two factors as space (distance) and place (context) effects (Beugelsdijk et al., 2010; McCann, 2011). We develop several hypotheses and test them using data on 124 European manufacturing subsidiaries from a wide range of home countries.

Our results provide support for part of our hypotheses and reveal that space and place have independent as well as joint effects on subsidiary host country political embeddedness. With these results, we aim to contribute to research in a number of ways. First, we contribute to the literature on subsidiary political behavior (e.g. Blumentritt & Nigh, 2002; Hillman & Wan, 2005; Luo, 2001). We show how space and place matter for subsidiary political embeddedness and provide support for the idea that political embeddedness carries both potential benefits and costs that need to be weighed up carefully by MNCs (Bucheli & Kim, 2012; Darendeli & Hill, 2016; Hadani & Schuler, 2013; Hillman, Zardkoohi, & Bierman, 1999).

Second, we advance literature by arguing that space and place are not only independent, but also interactive, i.e. both distance and host country context matter jointly (Mondejar & Zhao, 2013; Peng & Zhou, 2005). Third, we contribute to the institutional perspective in strategic management research. Our unique dataset allows us to differentiate between effects of distance and context on political embeddedness (van Hoorn & Maseland, 2016).

2. Conceptual background and hypotheses

2.1. Host country political embeddedness

Due to its foreignness, a firm can face hazards when it conducts business abroad (Eden & Miller, 2001; Hymer, 1976; Johanson & Vahlne, 2009; Kindleberger, 1969). More specifically, an MNC, as a *"stranger in a strange land"* (Eden & Miller, 2001: 4), bears a twofold burden: First, it may be treated less favorably than its host country local counterparts because of its foreignness. Second, it is likely to lack understanding of local institutions and customs, which can result in unfamiliarity hazards (Eden & Miller, 2001; Zaheer & Mosakowski, 1997).

Previous studies have identified strategies to mitigate foreignness hazards and establish legitimacy (e.g. Elango, 2009 for the United States; Luo, Shenkar, & Nyaw, 2002 for China). One such strategy is external embeddedness in the MNC host country political context (Halinen & Törnroos, 1998; Luo, 2001). It can help the MNC to obtain knowledge and understanding of the regulatory and political context, and to get access to networks. Moreover, it signals commitment, and can thus help the MNC to negotiate and construct legitimacy in a host country context (Kostova et al., 2008; Pache & Santos, 2013).

Notwithstanding the benefits of host country political embeddedness, it can also be a double-edged sword (e.g. Bucheli & Kim, 2012; Darendeli & Hill, 2016). The double-edged nature of political embeddedness underlines its strategic relevance for MNC management, and helps to explain why MNC research has witnessed an increasing interest in the antecedents and types of political embeddedness (for reviews see e.g. Hillman, Keim, & Schuler, 2004; Lawton, McGuire, & Rajwani, 2013; Lux, Crook, & Woehr, 2011).

Researchers have also paid attention to host country embeddedness of different MNC units (Andersson, Forsgren, & Holm, 2002; Forsgren, Holm, & Johanson, 2005; Yamin & Forsgren, 2006). Subsidiaries and headquarters can both be embedded in a host country, and thereby help to mitigate the hazards of foreignness and contribute to MNC success in the host country. Headquarters, however, are often embedded less strongly in host countries (Hoenen, Nell, & Ambos, 2014; Nell, Ambos, & Schlegelmilch, 2011; Yamin & Forsgren, 2006). This can partly be explained by MNCs' complex structures, i.e. the dispersion of operations across distance and in different country contexts (Kostova & Zaheer, 1999; Roth & Kostova, 2003).

In the contemporary view, MNC headquarters are seen as *"network orchestrators"* (Foss & Pedersen, 2002; Ghoshal, Moran, & Almeida-Costa, 1995). They are supposed to ensure coherence within the MNC, and coordinate and support their subsidiaries (Goold & Campbell, 2002; Nell & Ambos, 2013). Despite the geography of MNCs making it impossible for headquarters to strongly embed themselves in each host country, they can rely on the embeddedness, representation and local expertise of their subsidiaries (Birkinshaw, Hood, & Jonsson, 1998; Rugman & Verbeke, 2001).

2.2. MNC country-level influences and geography

It is widely acknowledged that country-level, i.e. geographic, factors imply differences in subsidiary behavior, and thus also in the degree of subsidiary host country political embeddedness within the MNC (Blumentritt & Nigh, 2002; Hillman & Keim, 1995; Lenway & Murtha, 1994; Rodriguez, Siegel, Hillman, & Eden, 2006). Yet studies often neglect the multidimensionality of geography, as claimed by scholars in economic geography and more recently also in international business (Beugelsdijk et al., 2010; McCann, 2011). Henisz and Swaminathan (2008) and Berry et al. (2010), for instance, highlight the need for the integration of both the multifaceted nature of distance and of country institutions as country-level factors in international business studies. McCann (2011), in particular, referred to these two distinct notions of geography as space (i.e. distance) and place (i.e. context).

The management of distance in the MNC is a difficult undertaking (Ambos & Ambos, 2009; Ghemawat, 2001, 2011; Kostova & Zaheer, 1999). To understand why this is the case, there have been calls for a more fine-grained study of distance, theorizing about underlying mechanisms and actual effects (Berry et al., 2010; Salomon & Wu, 2012). More specifically, scholars highlight the need to differentiate between difficulties in the management of MNCs caused by physical versus context-related dimensions of distance (Doz, Santos, & Williamson, 2001). The CAGE framework, in particular, covers both the physical dimension of geographic distance, as well as cultural, administrative, and economic distances, which describe contextual differences between different national contexts (Ghemawat, 2001, 2011).

Also, concerning the second dimension of geography, i.e. place, there is agreement among scholars that the country setting, comprising e.g. institutions or culture, has a critical impact on MNC management and international business in general (e.g. Morgan & Kristensen, 2006; North, 1990). Scholars advocate for an in-depth study of specific country-level factors to gain a deeper understanding of their effects on firm strategies (Jackson & Deeg, 2008). Instead of theorizing about the effect of highly aggregated and broad country-level constructs, they suggest using fine-grained constructs, which are more directly linked to the phenomenon being investigated. In the case of political embeddedness, for instance, the regulatory and political country context arguably has a more immediate impact than more general measures of institutional quality or culture.

MNC subsidiaries are located in unique contexts and at varying distances from the MNC home country (Kostova et al., 2008; Kostova & Zaheer, 1999; Roth & Kostova, 2003; Zaheer, Schomaker, & Nachum, 2012). Apparently, both notions of geography are relevant for MNC subsidiaries' behavior. Yet the question is how space and place influence subsidiary host country political embeddedness. Indeed, previous research suggests that MNC headquarters can support subsidiaries, provide *"a sense of direction, certainty, and legitimacy"* (: 998) and thereby help them tackle issues of foreignness. What is more, MNC research proposes that some subsidiaries will be more able to adopt efficient and effective practices from the MNC than others (Kostova, 1999; Kostova & Roth, 2002).

In this paper, we build on insights from the abovementioned pieces of literature to investigate country-level antecedents of subsidiary host country political embeddedness. We expect subsidiary host country