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# LETTER FROM THE EDITORS

Daniel Rottig, Ph.D., Editor

John Mezias, Ph.D., Associate Editor

With this issue of *AIB Insights*, we publish the 2018 edition of the Peter J. Buckley and Mark Casson AIB Dissertation Award, a focused issue series that is already in its sixth year. Since 2013, this series has become an invaluable conduit for the timely dissemination of the latest, state-of-the-art dissertation research in international business, and we are proud to continue the great momentum with this year's edition.

Each year, we publish the extended dissertation abstracts of the award-winning and award-nominated dissertations in international business. As in previous years, we have also asked our contributing authors to summarize their dissertation research in one "BIG" question in order to capture their extensive and exceptional scholarly endeavors in a brief and concise statement.

*Award-winning dissertation:*
"Firm's Economic Reliance to National Markets and the Corporate Provision of Public Goods: Evidence from Corporate Disaster Philanthropy" by Luis Ballesteros (Ph.D. awarded by The Wharton School, University of Pennsylvania, USA)
*BIG Question:* "What determines the engagement of business organizations in the provision of public goods, i.e., pro-social behavior, and what are the conditions and mechanisms of performance benefits associated with such behavior and those of an economic surplus for external stakeholders?"

*Award-nominated dissertations (in alphabetical order):*
"Country Familiarity: Three Essays on Entrepreneur Foreign Market Selection" by Daniel Clark (Ph.D. awarded by IE Business School, Spain)
*BIG Question:* "How do decision makers use their country familiarity when making foreign market selection decisions?"

"What Drives Tax Avoidance Strategies Adopted by US MNEs: Understanding the Heterogeneity of Approaches to Corporate Tax Planning in US Multinational Enterprises" by Maggie Cooper (Ph.D. awarded by the University of Reading, United Kingdom)
*BIG Question:* "What drives tax avoidance strategies adopted by US MNEs and why do they differ in their approaches?"

"Institutional Voids, Investment Purposes, and Foreign Subsidiaries of Multinational Enterprises" by Yamlaksira S. Getachew (Ph.D. awarded by Western University, Canada)
*BIG Question:* "How and when do institutional voids (the lack and/or absence of market-supporting institutions) have implications for the performance of foreign subsidiaries?"

"Essays on Nonmarket Strategy" by Jin Hyung Kim (D.B.A. awarded by Harvard Business School, USA)
*BIG Question:* "In light of the rising importance of nonmarket and political activities of firms, what are the drivers of these political behaviors and how do firms achieve positive economic outcomes through their nonmarket and political strategies in an international setting?"

On behalf of the AIB community, we would like to thank this year's AIB Dissertation Award Committee for their invaluable and dedicated efforts, work and commitment: Sumit Kundu (Florida International University, USA), who served as chair, Sumit Kundu, Shige Makino (Chinese University of Hong Kong, Hong Kong, SAR-PRC), David Reeb (National University of Singapore, Singapore), and Marcus Møller Larsen (Copenhagen Business School, Denmark).

On pages 24–25 in this issue, we also provide an overview of all previous winners of this prestigious award, starting with the award's founding year of 1968.

Congratulations to the 2018 AIB dissertation awardee and finalists for their significant accomplishments!

Daniel Rottig    John Mezias

# Firms' Economic Reliance to National Markets and the Corporate Provision of Public Goods: Evidence from Corporate Disaster Philanthropy

Luis Ballesteros
Ph.D. awarded by University of Pennsylvania, USA (May 2017)

**BIG Question:**
***"What determines the engagement of business organizations in the provision of public goods, i.e., pro-social behavior, and what are the conditions and mechanisms of performance benefits associated with such behavior and those of an economic surplus for external stakeholders?"***

## Introduction

"We are part of the same system. If the (Japanese) government cannot (orchestrate a reconstruction), we must rebuild. We need the market to recover," was the answer given by the VP from Coca Cola when I asked him about Coke's motives to donate in the aftermath of the 2011 earthquake and tsunami in Japan. At the time, I was working at the World Bank in disaster risk management and tasked with identifying potential sources of funding for relief and recovery. I would frequently encounter arguments that reflected this motive across my conversations with managers of multinational enterprises (MNEs) responding to the disaster. I had not started my Ph.D. program at Wharton, but these interviews had already provided me with the theoretical cornerstone for my dissertation: economic reliance on national markets (i.e., the share of corporate income explained by a given country) should affect the willingness of the firm to supply public goods (i.e., to behave pro-socially) and the degree that such behavior leads to performance benefits for the firm and an economic surplus for society at large. In the context of the disruption created by disasters, relief and recovery are public goods whose scarcity may reduce the expected profitability of firms that rely economically on the national market. The bigger the share of a firm's financial performance explained by a national market, the greater the strategic value for the firm of contributing to its relief and recovery.

Note that widespread arguments in the extant literature on non-market strategy, such as reputation and altruism, do not capture this simple causal intuition. Hence, I focus on economic reliance to contribute to the understanding of the determinants of non-market strategy by MNEs and its consequences for the firm and its stakeholders. In three chapters, I offer evidence that economic reliance facilitates the identification of (1) firms that are likely to engage in strategic philanthropy—i.e., the provision of cash and in-kind resources aimed at funding public goods that are key for firm performance, (2) firms that are prone to imitate the non-market behavior of rivals despite significant differences in size, performance, and market share, and be affected by stakeholders' perceived appropriateness of such behavior, and (3) firms comparatively capable to help countries increase or restore social welfare.

## Dissertation Overview

In the first chapter, I formally develop the concept of economic reliance by building on the theory of clubs (Buchanan, 1965). I argue that national markets are economic systems that firms join through their operation. I derive a mathematical model that shows that the effect of economic reliance is not explained by traditional theories in strategic considerations such as reputational capital with internal and external stakeholders, a social license to operate, an agency cost, or institutional pressures (Dorobantu, Kaul, & Zelner, 2017). Likewise, it is not captured by the social-preferences theories of altruism and fairness (Andreoni & Miller, 2002; Camerer & Fehr, 2002) Overall, this suggests that the effects of economic reliance on corporate pro-social behavior or CSR remains understudied.

My dissertation's main dataset is the product of a four-year collaborative project with researchers from the University of Pennsylvania Department of Computer and Information Science and the Wharton School, aimed at collecting and coding responses from firms, multilateral agencies, national governments, and non-profit organizations to every manmade and natural disaster that affected the world from 1990 to 2015.[1] It covers every monetary and in-kind donation reported in news media and 93,247 donations from 38,980 firms from 83 countries of origin.

In Chapter 2, I turn to the performance consequences of corporate pro-social behavior. Previous studies have documented that corporate pro-social behavior may be associated with performance benefits (Dorobantu et al., 2017). How firms realize such benefits is not trivial given the informational and time constraints under which some forms of non-market behavior, such as disaster philanthropy, takes place. For instance, about 84% of corporate donations to disasters come within three weeks of the disaster, hardly insufficient time for firms to conduct methodological due diligence on the damage to firm assets and the supply chain. Stakeholders also face great ambiguity in appraising the social value of a company's donations, given the fact that information on the human and material loss is not fully available for months or even years to come (Ballesteros, Useem, & Wry, 2017).

I focus on the apparent phenomenon of imitation: nearly two-thirds of disaster donations by firms are virtually the same as that of the first donor in the correspondent industry. If imitation momentarily drives a firm's pro-social behavior, it may well bring less financial advantage than in normal times. I draw upon the microfoundations of institutional theory to argue that firms concentrate on their rivals' financial standing while external stakeholders focus on firms' media reputation (Powell & Colyvas, 2008). Firms match the non-market behavior of high-revenue first movers because they believe that they are exemplary to identify and satisfy stakeholder expectations. On the other hand, stakeholders are especially likely to approve and reward companies with a pre-existing positive reputation because it signals that firms are selecting options whose means and ends are contextually appropriate. As a result, reputable first movers are prone to gain first-mover rents, but less reputable first movers are likely to suffer performance losses. This process generates imitation bandwagons that often result in aggregate losses because firms with high financial performance, but weak bad reputations often move first in the hopes of restoring their tarnished image.

My theoretical argumentation thus posits that organizational choices and its consequences on firm performance in a context of uncertainty and urgency are more a function of the legitimacy of the firm's social actions in the eyes of stakeholders than a function of the traditional metrics of financial performance. Moreover, corporate disaster giving is a non-market setting where firm choices are often disconnected from the social need, proxied by number of victims and the economic damage. Firms often gain performance benefits despite their donation being financially and socially suboptimal. I find that, 43% of the first movers and 51% of corporate donors obtained revenue losses not explained by their market operation.

> *"Relief and recovery are public goods whose scarcity may reduce the expected profitability of firms that rely economically on the national market.*

In the final chapter of my dissertation, I aim to address a weak spot in the non-market strategy literature where the social consequences of corporate pro-social behavior remain understudied (Dorobantu et al., 2017). We have lacked theory to predict when and why a firm's actions will create meaningful economic surplus, or the conditions under which businesses might be better able than other types of organizations to deliver such benefits. In the case of disaster philanthropy, while firms have the potential to contribute to social welfare based on their resources, this work may be best left to other entities that specialize in these activities and can be held accountable for their pursuit (Ballesteros et al., 2017).

Thus, I develop a theoretical model based on the dynamic capabilities literature. I argue that MNEs that are economically reliant to market systems, as compared to other types of entities that give disaster aid, have dynamic capabilities that enable them to sense areas of critical need more effectively following a disaster, mobilize resources hastily, and reconfigure assets for efficient responses. Hence, I predict that aid will arrive more quickly, and a nation will recover more fully, when economically-reliant firms account for a larger share of disaster aid. I further argue that these outcomes will be enhanced when disaster giving leverages firm-specific routines and resources.

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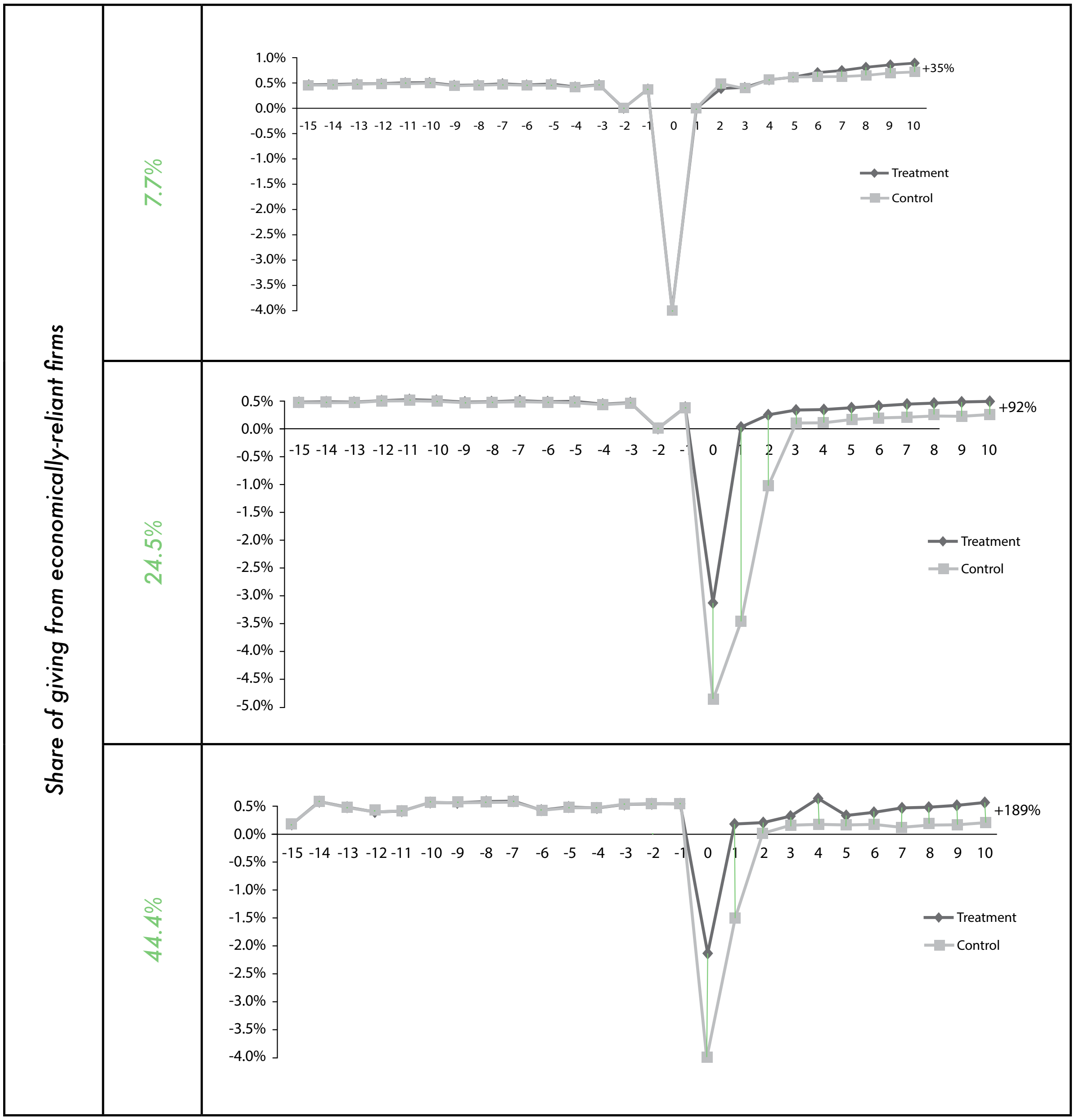
1 We covered newspapers, trade press, magazines, newswires, press releases, TV and radio transcripts, digital video and audio clips, corporate websites and reports, institutional websites and reports, and government websites and reports, among other sources.

*Figure 1. The Effect of Relatedness in the Relationship between Disaster Giving from Locally Active Firms and Disaster Recovery*




*Note: The outcome variable is the annual growth rate of HDI. Treated are disaster countries with at least 42.4% of in-kind giving that is related to the donor's core operation coming from firms economically active in the affected country (as defined by the 7.7%, 24.5%, and 44.4% cutoff points). Each figure shows the difference between the annual growth rates of HDI for treated and control nations 15 years before the disaster and 10 years after the disaster. The total sample of country-year disasters in the period 2003-2013 is 464.*

The findings of a quasi-experimental design confirm that economic reliance offers firms an advantageous position to help drive timely delivery of disaster aid. For instance, the level of recovery 10 years after the disaster is notably higher for countries that receive over 24.5% of disaster aid from locally active firms. On average, as seen in Figure 1, the growth rate of the Human Development Index for such nations is 92% higher than for their synthetic controls: this gap grows to 189% at the 44.4% of share of corporate giving.

## Framework and Findings

I hope that my dissertation's integrative theoretical framework that centers on economic reliance helps guide similar studies exploring the determinants and consequences of non-market strategy. Across the three chapters, I offer evidence that studying national markets as systems where entities share the costs and benefits of public goods exclusive of the market system is a useful methodology to predict corporate behavior and the implications for firm performance and social welfare.

This integrative framework results in more precise predictions than approaches employed in the extant literature. For instance, I show that monopolistic firms engage in pro-social behavior more frequently and in a greater magnitude than firms operating in fragmented industries. This challenges empirical work in the institutional and strategic philanthropy literatures suggesting that the benefits of corporate pro-social behavior are comparatively large in competitive industries where the quest and returns to differentiation are relative big (Kaul & Luo, 2017; Marquis, Davis, & Glynn, 2013).

My findings suggest that the effect of institutional factors on non-market strategy is more complex than the extant literature has suggested (Dorobantu et al., 2017). On the one hand, firms react positively to rule of law and accountability on the use of resources. Hence, institutional development may enhance corporate pro-social behavior (Amaeshi, Adegbite, & Rajwani, 2016). At the same time, when firms perceive that the government is incapable of supplying public goods, they increase their average giving. Taken together, my dissertation provides a more nuanced understanding of the role of national institutions in disciplining firms into a certain non-market strategy than previous studies.

> *My findings offer guidance on when and how the firm is more likely to extract rents by donating to disasters.*

Chapter 2 suggests that one source of debate in the literature on timing strategy (e.g, first-mover advantage) is the little attention to the drivers of stakeholder responses (Fosfuri, Lanzolla, & Suarez, 2013). I suggest a structural mechanism behind the social construction of performance advantages: when corporate behavior is a relatively novel phenomenon, stakeholders cope with uncertainty by focusing on easy-to-collect signals. These cognitive referents replace formal institutions and objective mechanisms based on probability estimates (Ballesteros, Wry, & Useem, 2018).

Finally, the findings in chapter 3 suggest that drawing on dynamic capabilities may help address a longstanding debate in the literature on non-market strategy. By confirming that economically-reliant firms are in an advantageous position to help drive timely delivery of disaster aid, thereby lessening the adverse effects of disasters on social welfare, my dissertation sheds light on the mechanisms that explain firms' comparative advantage to supply collective goods (Ballesteros et al., 2017).

## Implications

Regarding the managerial implications of my dissertation, the social impact of corporate social responsibility is a metric that is increasingly demanded by stakeholders and my dissertation offers a calculation method using measurable and unambiguous metrics. Given that corporate disaster philanthropy is increasing faster than other non-market strategies and such engagement is associated with performance benefits (Ballesteros, 2017)"abstract":"When firms decide to engage in the provision of collective goods that benefit social welfare (i.e., to behave pro-socially, understanding the conditions and mechanisms of such effects is of growing strategic value for managers. My findings offer guidance on when and how the firm is more likely to extract rents by donating to disasters. It identifies the firm-, industry-, and market-specific factors that managers need to consider when choosing the timing and magnitude of their philanthropy.

Regarding its social implications, responding effectively to natural disasters is a grand and growing challenge worldwide as the inflation-adjusted cost of disasters has sextupled in the last 40 years. At the same time, the level of aid from governments and aid agencies has been stagnant. Firms are increasingly called upon to address this gap, and have emerged in the past 25 years as a large contributor to humanitarian aid. Corporate philanthropy comprises a growing share of disaster relief, and for some disasters in the last seven years, it has exceeded the contributions of public aid and individual charity (Ballesteros, 2017; Ballesteros & Gatignon, n.d.)"abstract":"When firms decide to engage in the provision of collective goods that benefit social welfare (i.e., to behave pro-socially. The social value of corporate disaster philanthropy is thus likely to increase over time. My dissertation informs how such form of non-market strategy can be stimulated and disciplined to strengthen its positive benefits on business organizations and societies around the world.

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Luis Ballesteros (ballesteros@gwu.edu) is at the faculty of the GW Business School. He studies the individual and institutional drivers of organizational decision making under risk and uncertainty and the consequences of such choices for firm performance and economic development. Before receiving his PhD, Luis worked on industry development for the United Nations Development Program, disaster risk management for the World Bank, and in designing and trading market-based tools to hedge risk for JP Morgan.

# Country Familiarity: Three Essays on Entrepreneur Foreign Market Selection

Daniel Clark
Ph.D. awarded by Indiana University, USA (November 2017)

**BIG Question:**
***"How do decision makers use their country familiarity when making foreign market selection decisions?"***

Managers, executives and entrepreneurs make organizational decisions. These decisions are the product of individual cognitive decision-making processes. Whether a decision is made by one individual or by a team of people, whether it is highly scrutinized or made autonomously, or whether it is made analytically or intuitively, the decision was made by rationally bound and cognitively constrained individuals. In particular, the foreign market selection decision is enormously complex; there are innumerable potential critical variables to consider when selecting a host country: government stability, taxation rates, culture, geography, transportation infrastructure, language, and the competitive landscape, to name just a few. Each country considered has its own variables that need to be researched and compared to the firm's needs and expectations. So how do individuals make decisions when facing such complexity?

My three-essay dissertation examines how entrepreneurs engage the cognitive process of country familiarity in foreign market selection. Engaging this tool enables entrepreneurs to reach a reasonable conclusion within a reasonable exertion of cognitive effort.

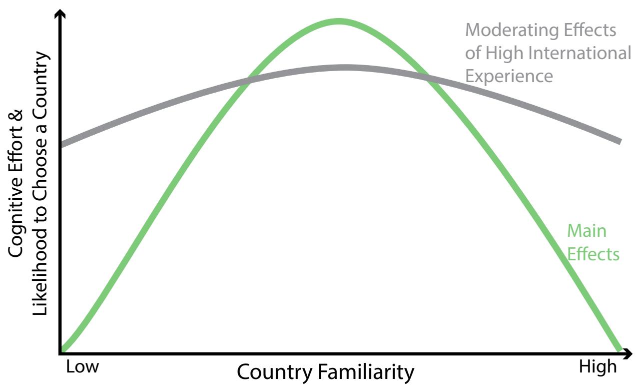
## Paper One: Country Familiarity in the Initial Stage of Foreign Market Selection

In the first paper, I look at how entrepreneurs use country familiarity. Cognition research has found that individuals have two sets of cognitive processes called System 1 and System 2 (Kahneman, 2003). System 1 processes are rapid, intuitive, use little information, and require little cognitive effort; System 2 processes are slower, analytical, use more information, and require more effort. Country familiarity, defined as the sense of knowing about a country, is a System 1 process.

I theorize that when country familiarity is low, the entrepreneur rapidly dismisses the country and wastes no further effort on it. At increasing levels of country familiarity, the entrepreneur commits additional effort to the recall of information about the country. These intentional recollections come with a confirmation bias; the entrepreneur is more likely to recall information that relates to the acceptability of the country as a destination. However, when country familiarity crosses a tipping point, and the entrepreneur has the sense that the country is very familiar, that familiarity prompts low effort spontaneous recollections. Spontaneous recollections do not have a confirmation bias; thus, the entrepreneur will be more likely to recall information that relates to the unacceptability of the country as a destination. These effects resulted in an inverted-U curvilinear effect of country familiarity on both cognitive effort and their country assessment.

I further investigate the boundary condition of international experience in the context of country familiarity employment in foreign market selection. High international experience reduces the influence of country familiarity as it provides decision makers with a perspective about what they need to know and do not need to know to evaluate the suitability of a country. As such, the entrepreneurs will be more reluctant to dismiss quickly both low and high familiarity countries, and engaged in more intentional recollections for both. Consequently, there was higher cognitive effort and likelihood of country selection at both the low and high levels of country familiarity. Figure 1 provides a visual illustration of my main theoretical arguments.

*Figure 1. Main Theoretical Arguments*




Using verbal protocol analysis, I ran 17 entrepreneurs through a series of 10 foreign market selection decisions to capture their decision-making thought segments, which enabled my analyses of how their country familiarity affected foreign market selection. Ample evidence was detected that entrepreneurs indeed actively employ country familiarity in foreign market selection. Country familiarity allowed the entrepreneurs to assess rapidly how much they thought they knew about each country. It influenced what information they used in the decision, how the decision was made, and ultimately the country they selected. I also found that the entrepreneurs' international experience moderated the effects of country familiarity.

There are several important takeaways from these findings. First, country familiarity is a long-neglected yet important cognitive process useful for understanding individual cognition in foreign market selection. Second, individual cognition, in particular intuitive (not just analytical) decision making, is critical for managing cognitive effort in foreign market selection. Third, international experience plays a meaningful role influencing the use of cognitive processes in foreign market selection. Future foreign market selection research would be well advised to consider individual cognition as a component in decision making, and country familiarity is likely a useful tool for this purpose.

## Paper Two: Knowledge Proxies and Internationalization

One of the interesting components from the previous paper is that country familiarity informs the decision maker about the availability of information without them necessarily accessing the information, and that decisions were made on the strength of the proxy. This means that country familiarity is a knowledge proxy. The internationalization literature (see Clarke, Tamaschke, & Liesch, 2013; Coviello & Munro, 1995; Dow, Håkanson, & Ambos, 2014; Williams & Grégoire, 2015) has identified other important knowledge proxies, such as psychic distance (indicates the availability of information from external sources), networks (information from connections), home–host similarity (information extrapolated from the home country), and country specific experience (information from personal exposure). In this paper, I conduct a conjoint analysis experiment with 100 entrepreneurs, asking them to make 16 country assessments based on differing levels of each of these five knowledge proxies, to examine the relative value of these knowledge proxies in foreign market selection and their unique contribution in international business research.

Conjoint analysis allowed me to disaggregate and evaluate the unique contribution of each knowledge proxy to foreign market selection decision making. What I found was that entrepreneurs used all of the knowledge proxies. They had no single identifiable preference for one proxy over another; meaning there were no interactions and no obvious "winner". However, there were some differences between the proxies; psychic distance and then country familiarity had the largest influence on specific choices. Beyond the value of each individual proxy, generally, it was more important to have more proxies than specific proxies available; suggesting that beyond the source of information, entrepreneur decision making may be strongly influenced by perception of the quantity of information available.

I also examine how entrepreneurial motivations (entrepreneurial self-efficacy and entrepreneurial drive) moderate how knowledge proxies are used. The first moderator I looked at was entrepreneurial self-efficacy (sometimes called entrepreneurial confidence), the degree to which an entrepreneur believes they will be successful in entrepreneurial activities. Entrepreneurs with high self-efficacy, have the tendency to improvise and to make do with what they have. They tend to terminate information searches earlier than those with lower self-efficacy. As such, those with high self-efficacy were more likely to use and attributed greater importance to each knowledge proxy. The second moderator was entrepreneurial drive. To measure drive, I created a new scale called individual international entrepreneurial orientation (IIEO). To build and validate the scale I followed best practices using three separate samples of students and entrepreneurs. Those with entrepreneurial drive are motivated to take risks, to innovate, and to act proactively; they are also more likely to use the knowledge proxies to make foreign market selection decisions.

This essay delivers several important theoretical contributions. First, country familiarity is useful even in the presence of the more established knowledge proxies. Second, information quantity attracts entrepreneurs, which is somewhat counterintuitive given that entrepreneurs employ country familiarity to reduce cognitive effort, and additional information increases effort—it may be that information is like insurance, entrepreneurs want to know it is there even if they do not want to use it. Third, motivations play a key role in how entrepreneurs use knowledge proxies, including country familiarity, in decision making. Finally, I developed a new measure, the IIEO scale, which builds on the established entrepreneurial orientation (Covin & Wales, 2012) and international entrepreneurial orientation (Covin & Miller, 2014) literature, and fills the need for an individual-level scale. Interestingly this scale also seemed to predict the likelihood that entrepreneurs would want to internationalize; high IIEO entrepreneurs had higher country assessment scores regardless of the number of knowledge proxies present.

## Paper Three: A Multi-Dimensional Perspective of Country Familiarity

For each of the two previous papers, I considered country familiarity as a single general construct. However, the definition of country familiarity as a sense of knowing about a country raises a natural question: "knowing what?" Research in international business has found that there are many aspects of a country that can influence its attractiveness to potential investors (Nielsen, Asmussen, & Weatherall, 2017). They are country institutions, culture, industry competition, available products, and customer markets. In this paper, I consider a multi-dimensional view of country familiarity. I examine the relative importance of an entrepreneur's familiarity (sense of knowing) with a county's institutions, culture, industry, products, and markets.

Using the same sample from the previous study, I conducted a second conjoint analysis experiment. I also utilized a unique analytical technique that allows the integration of the information two separate conjoint exercises. In this study, I examined the relative effects of each dimension of country familiarity and examine the potential moderating effects of the entrepreneur's cognitive style; the individual's unique preferences for how they make decisions. I evaluated their cognitive style (either intuitive or analytical) from the prior study's data.

Empirical evidence shows that each of the country familiarity dimensions had a significant positive effect on the country assessments of entrepreneurs. The order of influence (from most to least) was product, market, industry, culture and then institutional familiarity. Because of the direct effect of IIEO in the previous study, I included both entrepreneurial self-efficacy and IIEO as controls in this study. Again, I found a significant direct effect of IIEO on country assessments, providing more evidence of the effect of IIEO on the tendency to internationalize.

The moderator analysis from this paper was particularly interesting. Those with an intuitive cognitive style were more prone to attribute importance to each of the five country familiarity dimensions, which is logical, as an intuitive person is more likely to rely on their intuition. In comparison, entrepreneurs with an analytical cognitive style used country familiarity dimensions more strategically. These entrepreneurs were more likely to use their familiarity when information was particularly expensive, difficult to obtain, or potentially unreliable, specifically their product and market familiarity. There was no effect of analytical cognitive style on either institutional, cultural or industry familiarity.

The first key takeaway from these findings is that country familiarity is a multi-dimensional construct, and is useful both when considered as a single general construct or through its separate dimensions. However, we still do not know much about the relationship between country familiarity and its dimensions. Second, entrepreneurs consider familiarity with institutions, culture, industry, products and markets important in foreign market selection; the absence of any of these can affect the likelihood of country selection. Third, cognitive style matters. Individuals use familiarity differently based on their decision-making preferences. People that are more intuitive are more likely to rely on their familiarity, while more analytical people will selectively apply familiarity to supplement or compensate for other types of information.

## Summary of the Dissertation's Contributions to Theory and Practice

Beyond the contributions of the individual papers described above, my dissertation makes additional theoretical contributions. First, I introduce country familiarity to the literature in foreign market selection. I repeatedly show that country familiarity, which can be either a general or a multi-dimensional construct, influences foreign market selection decision making. It plays a key role in helping decision makers to manage their cognitive effort, but also influences what decisions they make, reinforcing the importance of understanding individual cognition in foreign market selection. Second, decision makers use knowledge proxies in the place of information to help reduce cognitive effort. Knowing that information is available if needed provides the decision maker freedom to make choices without the cognitively effortful processes of searching for and sorting information. Country familiarity is one knowledge proxy, but there are many others. Third, I introduce to foreign market selection research two useful methodologies: IIEO and the iterative conjoint analysis technique. IIEO will help future researchers measure an individual's drive to internationalize, and the iterative conjoint analysis technique allows researchers to consider decision-making sequence when using conjoint analysis.

My dissertation also makes important practical contributions. It is important for entrepreneurs to understand the effect that country familiarity has on their decision making. We all use

System 1 tools, and we trust them, but they do affect the choices we make. Research has shown that individuals can opt to use analytical processes to check and backstop their intuitive processes (Kahneman, 2003). The more comfortable an entrepreneur is with intuitive decision making, the more important it is for them to consider the potential biases that country familiarity and other System 1 processes have. Using analytical processes selectively, to confirm their decision making, does not need to dramatically increase decision effort. Another option is to involve others (coworkers, friends, or network links) in the decision and allow them to provide a "sober second thought" to the primary decision maker. The lesson here is not "don't trust country familiarity," which is neither accurate nor practical. Country familiarity is useful because it works, and research has shown that System 1 decision making can be very accurate (Gigerenzer & Gaissmaier, 2011). However, foreign market selection decision making is both complex and risky, and for those particularly prone to favoring one cognitive process, verifying the decision is simply prudent. This is particularly true for confident and driven entrepreneurs. The more entrepreneurs trust themselves and their abilities and the more that they "want" to pursue international opportunities; the more likely they are to use country familiarity to help them make their decisions.

Country familiarity is unique in that it is both an important component of foreign market selection cognition, and is easily accessible by both decision makers and researchers. One can assess their own country familiarity at any time, and can provide that information to others with ease. That ease is what makes country familiarity so influential; it is effectively the most accessible foreign market selection tool. The fact that entrepreneurs, and likely other managers, use country familiarity is not surprising, but its effect on decision making and its apparent centrality to the foreign market selection process is surprising.

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# What Drives the Tax Avoidance Strategies Adopted by US MNEs? Understanding the Heterogeneity of Approaches to Corporate Tax Planning in US Multinational Enterprises

**Maggie Cooper**
Ph.D. awarded by University of Reading (December 2017)

**Big Question:**
***"What drives tax avoidance strategies adopted by US MNEs and why do they differ in their approaches?"***

## Introduction

My thesis considers the question: "What drives the tax avoidance strategies adopted by US MNEs?" The innovative research aims to provide a greater understanding of the different approaches to corporate tax planning used by US multinational enterprises (MNEs) and their subsidiaries in the UK. I used a mixed methods approach, driven by the need to generate new data in an area where confidentiality is key. My research included a series of interviews with senior tax executives, statistical analysis of a new hand-collected database of 94 companies and a series of case studies based on secondary data.

In recent years corporate tax avoidance has come under scrutiny from the public, the media, and the government; this thesis argues that it is vital that academic research is able to contribute to and lead this debate. There is a growing awareness of the ability of multinationals to shift profits between countries, that they can choose where to book profits and therefore where they pay tax. This ability to shift profits is increasing, with competition between countries intensifying as they reduce statutory tax rates in order to attract FDI.

Whilst tax may not drive the fundamental strategic direction of an MNE, it is likely to be considered as a key factor in the implementation of strategic plans. Cases such as the failed $160 billion Pfizer–Allergan merger (*Financial Times*, 2016) and the European Commission's conclusion that the agreements between Ireland and Apple constituted a breach of the EU state aid rules (*Economist*, 2016) and the demand that they pay €13 billion in additional tax and interest, demonstrate the scale of potential tax savings. Policymakers need information about the factors that drive the level of aggression with which MNEs pursue a tax avoidance strategy. It is generally understood that the current tax system fails to deal well with modern companies, and digital companies in particular. Many of the companies that are cited as tax avoiding companies operate in the digital sphere (including Facebook, Google, and Amazon) but others such as Starbucks operate with a more traditional "bricks and mortar" business model. Consequently, my research endeavours to provide a greater understanding of what drives the differences between companies. I also argue that this is an important area of study for those working in the field of IB which has been neglected in recent years, although I welcome the more recent publication of articles in this area.

The literature review for this thesis draws on work conducted in the fields of accounting, public economics, and finance. The cross-cutting approach gives a comprehensive overview of the issues and again clearly highlights the need for new work to be carried out from within the field of international business (IB).

My empirical findings are broad, with implications for researchers, practitioners, and policymakers. I demonstrate that MNEs, or those working within them, make choices about how much tax should be paid and which locations they should pay it in. The scope for decision making in this field is not reflected in previous studies. Tax regulations provide a framework for MNEs to operate within but there is still much scope for decision making and interpretation within these rules. The findings from the interviews show the importance of the people and culture inside the business in terms of setting the tone for tax planning and strategy and the risk that the organisation is prepared to take.

My statistical analysis generates substantial new information about the characteristics of companies and what drives tax avoidance. The ownership of intellectual property and the use of tax havens give firms the ability to reduce the taxes paid. Similarly, the larger the company, the less tax is paid. The more women there are on the board of a company, the more tax is paid.

My research makes another new finding: MNEs adopt strategies to optimise rather than minimise their corporation tax expense. This can make measuring tax avoidance and evaluating the scale of the problem difficult. There are important findings in my comparison of different measures of tax paid for researchers who want to understand the ways in which these measures differ.

> *"Corporate tax avoidance has come under scrutiny from the public, the media, and the government; this thesis argues that it is vital that academic research is able to contribute to and lead this debate.*

## Research Methods

The adoption of the specific research methods used for this thesis was driven by the need to find data that would contribute to a comprehensive understanding of what is happening inside the "black box" of the company. A holistic and systematic mixed methods approach was used, including both qualitative and quantitative methodologies. The combination of different approaches helps to overcome the issues of confidentiality, which are clearly significant when researching in this area.

The first empirical study is based on a series of eleven interviews with senior tax executives from UK subsidiaries of US MNEs and experts of tax advisory firms, focusing on the experience of the MNE subsidiaries operating in the UK. The interviews were analysed using Nvivo specialist software, enabling specific themes to be identified and used to code the interview transcripts.

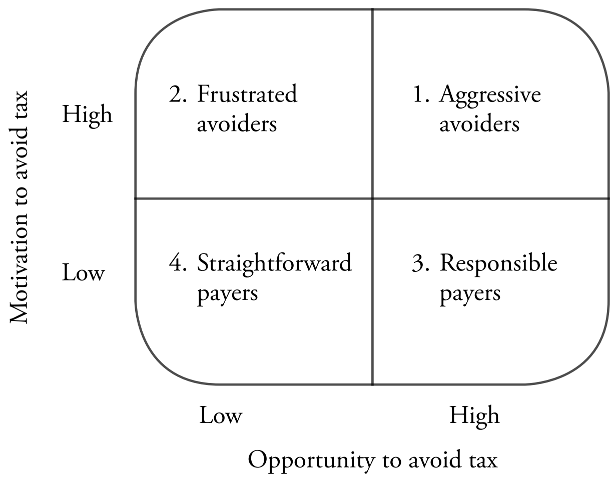
The second empirical study concerns the statistical analysis of a hand collected database of 94 largest US MNEs operating in the UK. The size of the database was carefully considered to ensure that the findings could be effectively analysed using statistical techniques but this was balanced against the necessity to generate data that could be interpreted with reference to the individual companies. This, therefore, enables the data analysis to contribute to establishing a holistic view of the focal companies. Significant new findings are generated using multiple regression techniques. The statistical analysis is complemented with outlier analysis and the case studies discussed below.

In the third empirical study, an indepth analysis of a series of six case studies (Amazon, Ford Motor Company, Goodyear Tires, Google, Starbucks, and Nucor) are presented. The case studies are developed using content analysis methodology based on published accounting data and other company information (e.g., management discussion, disclosure notes, and organizational structure and business configuration) and public information sources. The case studies make a clear contribution by providing a rich, detailed analysis of the companies involved over a ten-year time horizon. The case studies aim to complement the findings from the previous two empirical studies — the interviews and the parent-level data analysis.

## Theoretical Contribution

Internalization theory underpins the research contained in this thesis. Tax was explicitly at the centre of research interest in early IB theory (Rugman, 1980; Rugman & Eden, 1985), which discussed the benefits that transfer pricing and tax confer on the MNE; tax planning, it was argued, gives MNEs a financial advantage over domestic companies. Internal financial transfers enabled MNEs to overcome the liability of foreignness and external capital market imperfections (Hymer, 1976). Over time, however, these transfers within the MNE came to be seen as less central to the overall theory of the MNE. Transfer pricing, referring to the prices used for the flow of intermediate or finished goods or services between affiliates of the same firm, is now viewed simply as a mechanism employed by MNEs to avoid taxes rather than as a core, innate part of the advantage of the MNE (Casson 1979).

*Figure 1. Motivation–Opportunity Matrix*




Tax avoidance was explicitly included in Dunning's (1993) work on motivation — not in the "big four" that are so commonly quoted, but as part of the "escape" motive. He directly addressed tax avoidance as a motive for FDI here. My work considers the different factors that could affect a MNE's motivation to avoid tax, in combination with the opportunities that are available to them. I categorise companies using a 2x2 matrix (see Fig. 1).

This is one of the key theoretical contributions made in my thesis. Further work is now needed to test this framework.

## Empirical Work

The three separate research studies each make significant new empirical contributions to the literature. Specifically, findings from the innovative interview research, supplemented with the parent companies and the UK subsidiaries' annual reports, prospectus, and documents, suggest the importance of aspects such as the experience of individuals and the company's overall attitude to risk, that the development of theory must take into account. The research clearly demonstrates that the background and experiences of those involved in setting and managing tax policy within the MNE will have an impact on its overall strategy. The overall aggressiveness of behaviour that emerges will be a consequence of motivations and opportunities available to MNEs.

As discussed above, the regression analysis investigates the importance of different characteristics of the firm and the impact that these have on their tax avoidance strategy. This study offers an in-depth analysis of a small dataset. An economic model is established and hypotheses are drawn from this model. These are then tested, revealing the importance of intellectual property and tax havens as means of reducing the effective tax rate (ETR) paid. The number of tax haven subsidiaries does not appear to impact the level of tax paid as companies had between 179 and zero tax haven subsidiaries. The advantage is conferred simply by having a single tax haven subsidiary.

The size of a firm and the proportion of women on the board are important factors in determining the level of aggression with which a MNE addresses its corporate tax planning. In other words, the largest companies and those with fewer women on the board pay less tax. My analysis also confirms that MNEs adopt strategies that enable them intentionally to avoid taxes and that some firms pursue these more aggressively than others. Again, the scope for decision makers to have an impact on tax strategy is clear.

The case study research presents important new detailed information about the role of tax planning within the MNEs studied. The case studies demonstrate the broad range of approaches adopted by MNEs and the impact that this has on their corporate strategy as well as on the financial reporting. These case studies also demonstrate the potential for robust data generated through the in-depth analysis of annual reports to contribute to future IB research.

It is argued that one reason for the neglect of this area is the difficulty encountered in gaining access to information due its highly confidential nature. The innovative triangulation of qualitative and quantitative research methods used demonstrates that whilst data is hard to access, it is not impossible. The case studies, in particular, highlight the depth of information that is available to researchers within annual reports, a source which is often overlooked by IB researchers who may lack the technical skills to access it.

## Implications for International Business Theory and Practice

In this thesis I argue that tax has risen up the political agenda, particularly since the financial crisis of 2008. Governments, the OECD, and the EU have all generated work programmes to understand profit shifting and tax avoidance. My three pieces of research demonstrate the flexibility that MNEs currently experience within the international tax regime given that the differentials in tax rates across countries provide MNEs with vast opportunities for arbitrage. MNEs demonstrate behaviours that enable them to plan their tax liabilities.

This research will add to policymakers' understanding of MNE corporate tax planning and strategy. Understanding the way in which decisions made within the "black box" of the MNE is imperative to generating effective government policy. Understanding the means by which MNEs exploit lower tax rates to reduce their overall corporation tax bill is essential for public policymakers wishing to change MNE behaviour.

My thesis demonstrates that MNEs do not adopt a homogenous approach to tax planning, and government policies need to respond to these differences. MNEs operate across borders and the case studies presented demonstrate the extent of the impact of tax planning on their corporate structures and behaviour. Without a similar transnational perspective, governments will be at a disadvantage compared to the MNE, focusing on a smaller jurisdiction than does the MNE. As the length of value chains increases, all MNEs, not simply those involved in digital industries, will be able to exploit tax planning possibilities.

There are clear implications for the managers of MNEs – both at the headquarters and at the subsidiary level. Management needs to be clear that when they are setting their tax planning strategy they are making a choice with implications not only for the corporation tax paid but also, potentially, risks to the business including those of public perception and potential damage to their corporate reputation. Executives should actively manage their tax planning strategy in the light of these potential trade-offs.

## Conclusion

This is an important area for MNEs. Tax is often the single largest bill that they pay during the year. It directly affects their behaviour and the implementation of strategy. It is vital that IB research is conducted in this area to ensure the relevance of the field to policymakers as well as managers. The research in this thesis takes an innovative approach to generating new information. The data generated then highlights significant differences in approaches taken between companies and the importance of decision making by corporate management.

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# Institutional Voids, Investment Purposes, and Foreign Subsidiaries of Multinational Enterprises

Yamlaksira S. Getachew
Ph.D. awarded by Western University, Canada (October 2017)

**BIG Question:**
***"How and when do institutional voids (the lack and/or absence of market-supporting institutions) have implications for the performance of foreign subsidiaries?"***

## Introduction

Institutional voids represent a core phenomenon of interest in the international business (IB) research focusing on emerging markets. While this research has advanced our understanding of the phenomenon and its implications for MNE investment, strategy, and management, a closer examination reveals two potential shortcomings. First, much of the research in the area has emphasized the economic implications of institutional voids: institutional voids engender transaction-cost market imperfections, which constrain market exchanges and therefore limit efficiency. This perspective has been central to our understanding of institutional voids as hazards. However, a careful reading of IB research drawing on industrial organization theory (e.g., Stephen Hymer's contributions) suggests potential for institutional voids to generate structural market imperfections, which present market power advantages for incumbent MNEs (Dunning and Rugman, 1985) and thus suggest a consideration of institutional voids as advantages. A more complete understanding of institutional voids and their implications, therefore, requires a better appreciation of the associated transaction-cost and structural market imperfections. Research in the area needs to engage both the economic challenges institutional voids generate and the strategic advantages (i.e., market power advantages) they present. This dissertation aimed to do just that and by doing so sought to advance our understanding of this important phenomenon.

Second, research in the area provides only a limited understanding of whether and how MNE investment motives/purposes interact with host country institutional contexts to affect subsidiary strategy and performance. Research on investment motives/purposes is important as it can provide a useful departure from existing emphasis on the "how" questions (e.g., entry mode research) and draw scholarly attention to the 'why' questions of FDI. Prior research on investment motives (purposes) and subsidiary mandate/charter has advanced our understanding of the inherent strategic as well as structural heterogeneity among MNE affiliates (subsidiaries). However, we have a limited understanding of how such heterogeneity relates with the ability to deal with the hazards of (or tap the opportunities from) host country institutional voids.

This dissertation, therefore, aimed to address the aforementioned gaps. In particular, it sought to answer the following research questions: (1) whether, how, and when host country institutional voids have implications for the performance of foreign subsidiaries and (2) whether, how, and when investment purposes/motives for which foreign subsidiaries are established relate to the extent to which the subsidiaries/their parents overcome the hazards of (or capitalize on the opportunities from) operating in locations of high institutional voids.

## Overview of the Dissertation

The dissertation is organized as a collection of three integrated essays. Collectively, the essays contribute to a better understanding of the structural and transaction-cost market imperfections associated with institutional voids. Whereas transaction-cost market imperfections have been central to research in institutional voids, this dissertation brings a scholarly attention also to structural market imperfection, which are endogenous to firms. Likewise, it advances our understanding of the strategic and economic implications of institutional voids for foreign divestment. In addition, by integrating insights from the investment motives and subsidiary mandate/charter literatures, the dissertation contributes to a better understanding of purposes underlying foreign investment and their performance implications. Further, the dissertation contributes to the notion of foreign divestment especially from locations characterized by high institutional voids and market imperfections.

The first essay draws on insights from the new institutional economics and industrial organization theory to examine the economic and strategic implications of entry to the African market. By leveraging insights from the investment motives literature and the subsidiary mandate/charter literature, the essay also examines the roles of investment purpose diversity and market-seeking orientation. To test the arguments in this essay, I used a paired-sample design of Japanese foreign subsidiaries entering Africa and OECD countries. Results from extended cox regression models generate useful insights. The empirical evidence suggests that Japanese foreign subsidiaries that entered the African market have a greater likelihood of exiting than their counterparts in the OECD markets. This finding indicates that the economic (i.e., transaction cost) challenges of entry to the African market outweigh the associated strategic (i.e., market power) advantages.

*“Collectively, the essays contribute to a better understanding of the structural and transaction-cost market imperfections associated with institutional voids.*

The empirical evidence also suggests that Japanese foreign subsidiaries that entered Africa with diverse investment purposes and/or greater market-seeking orientation are less likely to exit than are their counterparts. These findings, thus, present investment purpose diversity and market-seeking orientation as potential mechanisms to mitigate the economic challenges of institutional voids. Further, the findings as well as theoretical arguments associated with investment purpose diversity can contribute to extending the firm scope argument to a subsidiary level. The essay introduces the notion of subsidiary scope, here represented by the within-subsidiary diversity of purposes, and advances an understanding of its implications for foreign subsidiary exit (or survival). As well, by considering investment purpose diversity, the essay addresses a call by Adner (2007) to engage the notion of flexibility by reassignment of resources (shifting resources to a more favorable activity in a subsidiary). Also, it finds that the unique structural and strategic attributes of market-seeking subsidiaries can help offset the hazards of institutional voids.

The second essay examines the effects of host country market and institutional conditions on the survival likelihood of market-seeking subsidiaries. The viability of such subsidiaries is contingent on the presence/absence of sufficient market opportunities in the host country. This essay argues that the pattern of income distribution in the host country is an important variable in determining market attractiveness and seeks to explore how this variable relates to the survival (or exit) probability of market-seeking subsidiaries. Drawing on insights from research in environmental munificence, market imperfection, and the NIE, the essay sought to examine the complex ways in which host country income distribution is associated with survival of market-seeking foreign subsidiaries. As well, it explored institutional boundary conditions for the proposed relationship.

Analyses of subsidiary-, parent-, and country-level data on 6,699 Japanese market-seeking subsidiaries operating in 47 countries suggest that host country income distribution has a complex relationship with subsidiary survival. Specifically, the essay finds empirical evidence suggesting a presence of a U-shaped relationship between income distribution and subsidiary exit in that subsidiary exit is high in host countries with highly egalitarian or highly dispersed income distributions. This empirical evidence supports the notion that market-seeking subsidiaries face a lower likelihood of exit in host countries with intermediate levels of income distribution (as measured by the Gini index). Post-hoc analyses indicate the inflection point to be at a Gini index of approximately 38. The maximum and minimum Gini indices in the data are 57 and 22 respectively, and lower Gini score indicates more egalitarian income distribution.

Empirical findings also uncovered another layer of complexity in the relationship between income distribution patterns and exit of foreign market-seeking subsidiaries. The study finds that host country institutional development offsets the hazard posed by extreme levels of income distribution. By reducing transaction and information costs associated with exchanges, free-market institutions compensate for the product and factor market limitations that extreme income distributions engender and improve host country munificence. As well as advancing a more nuanced understanding of how host country income distribution relates with survival of market-seeking subsidiaries, this finding suggests the potential interaction between market and institutional factors and points to the need to examine such interactions to gain better understanding of subsidiary exit.

The third essay advances theoretical arguments about the strategic implications of institutional voids by considering the potential effects of alternative governance structures to organize the relationship between MNEs and host countries. In emerging markets, where institutional voids abound, governments play a more active role in business activities and political connections yield greater benefits to business performance. Whereas existing research indicates the presence of different governance structures (or bargaining models) underlying foreign direct investments in developing countries, synthesizing these approaches and examining their comparative performance implication has been largely limited. This essay aims to contribute to filling this lacuna by identifying three alternative bargaining models – namely, the one-tier bargaining, the modified one-tier bargaining, and the two-tier bargaining models – and theoretically examining their characteristics using arguments from Hillman and Hitt (1999) about the nature of political actions. In doing so, the essay not only advances a better understanding of these bargaining models and their implications, but also offers a potential explanation for the increasing competitive edge of Chinese MNEs in such developing countries as those in Africa (e.g., UNCTAD, 2015).

Following Hillman and Hitt (1999), the essay categorizes the three bargaining models along the two dimensions of the level and nature of political participation. The level of political participation takes either individual (i.e., MNE) or collective (i.e., state); the nature of political participation includes transactional or relational. Thus, using the dimensions, the essay identifies that the modified one-tier model – typically characterizing Chinese resource-seeking FDI in such developing countries as those in Africa – follows the collective-relational approach to political connection. To establish a theoretical link between a given bargaining model and competitive advantage benefits spilling over to associated subsidiaries, the essay first forwards theoretical mechanisms suggesting the marginal benefits of using collective as well as relational approaches to political connection. Then, it integrates mechanisms along the two dimensions to forward a proposition suggesting the value to competitive advantage of using the collective–relational approach (or the modified one-tier bargaining model). The proposition suggests the presence of influence rent and its potential implications for market competition. Resource-based view, resource dependence theory, and the NIE provide the requisite foundations for the theoretical development.

*Findings from this dissertation also suggest the need for organizations to consider socio-economic forces more closely and critically.*

The essay further refines its theoretical development by identifying relevant boundary conditions to the proposed relationship. It identifies investment motive and institutional development (economic and political) as potential boundary conditions influencing the baseline argument (i.e., the positive relationship between the use of the collective-relational approach and competitive advantage). The greater asset specificity characterizing resource-seeking investments can give rise to an increased threat of opportunistic behavior by host country government. Such investments, therefore, place MNEs at a less favorable bargaining position. In such instances, the collective-relational approach is likely to be the most preferred. The presence of a collective actor such as the home government and the inherent commitment to building long-term relationships underlying this approach can circumvent threats from reduced bargaining power. The essay also advances theoretical arguments suggesting that development of institutions can undermine the need for and value from strong political connections. As economic and/or political institutions develop, MNEs tend to enjoy increasingly better protection of property rights and enforcement of contracts. Under such conditions, the potential spillover advantages flowing to foreign subsidiaries drawing on the collective-relational approach is likely to be inconsequential. These arguments point to the potential tradeoff between market power advantage (through such strategizing efforts as political connection) and efficiency advantage (through reduced transaction costs).

## Contributions to Theory and Practice

Collectively, this dissertation makes the following empirical and theoretical contributions. First, by engaging both the economic and strategic mechanisms underlying institutional influences, it advances a more nuanced understanding of how host country institutional conditions relate to foreign divestment. Second, it integrates insights from the eclectic paradigm of foreign production and the investment motives literature to respond to calls for research looking at the interaction between location factors and investment motives. Third, it contributes to the institutional voids literature by suggesting response mechanisms operating at the subsidiary level (i.e., investment purpose diversity and market-seeking orientation) and at the multi-party bargaining level (i.e., the collective–relational approach). Fourth, it contributes to our understanding of how the effects of host country (dis)advantages can be best understood by identifying a form of organization for which such factors are more relevant. Fifth, it extends the investment motives literature by indicating the useful insights to be generated by considering the fine-grained aspects of investment motives (i.e., investment purposes). Sixth, global strategy research has largely ignored Africa as a research setting and income inequality as a phenomenon, limiting our understanding of both. This dissertation responds to the numerous calls to help fill these gaps. Finally, it advances our understanding of foreign divestment by considering how market conditions, market-supporting institutions, and their interactions with investment motives relate with foreign divestment.

As well, the dissertation generates insights that practitioners and/or policymakers may find useful. Understanding that institutional voids have strategic implications, as well as economic implications, is useful for practitioners as it (1) broadens their understanding of host country institutions and (2) helps them in devising mechanisms to deal with or leverage such institutions. Further, practitioners can also learn about, and wherever possible use, the response mechanisms identified to mitigate the economic challenges of, or take advantage of the strategic benefits from, institutional voids. For policymakers, it provides a useful reference regarding the implications of unavailable institutions for the long-term viability of foreign MNE subsidiaries. It also provides a better understanding of how developments in both political and economic institutions can promote and/or discourage rent-seeking behavior of home countries, MNEs, and/or their subsidiaries.

By emphasizing the heterogeneity in foreign subsidiaries with respect to their motives and/or purposes, the dissertation also helps inform decision making both at the firm and host country levels. At the firm level, its findings suggest that the interface between host country institutions and subsidiary performance depends on the motives driving the subsidiary. For example, the dissertation indicates that resource-seeking subsidiaries are less likely to develop the capability to deal with host country institutional voids and therefore other mechanisms need to be used to create/promote such capability. The dissertation offers suggestions regarding some of these mechanisms. At the host country level, the dissertation can inform policy decisions by generating insights about the strategic and structural differences among different kinds of subsidiaries. It provides empirical evidence suggesting that policy prescriptions to attract and/or retain, for example, market-seeking subsidiaries are likely to be different from those used for resource-seeking subsidiaries.

Findings from this dissertation also suggest the need for organizations to consider socio-economic forces more closely and critically. Particularly, they show how the probability of subsidiary exit changes along different levels of income distribution. In like vein, this dissertation provides the management of MNEs with useful information about the exit risks associated with different investment locations that have different income distributions. Finally, for host country governments, these results provide empirical evidence about when and how income distribution relates to business exit, thereby informing pertinent policy decisions.

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# Essays on Nonmarket Strategy

Jin Hyung Kim
D.B.A. awarded by Harvard Business School (May 2017)

**BIG Question:**

***"In light of the rising importance of nonmarket and political activities of firms, what are the drivers of these political behaviors and how do firms achieve positive economic outcomes through their nonmarket and political strategies in an international setting?"***

## Introduction

A *Washington Post* (2013) article reports that "big companies realized that a few million spent shaping legislation could produce windfall profits," which reflects the fact that many firms see the benefits of nonmarket and political activities. However, it is also true that many company executives often doubt and are uncertain about how they can realize positive outcomes through such activities. The importance of nonmarket activities is not just limited to domestic firms. Foreign firms always face the need to deal with regulatory and institutional environments different from that of their home country when they enter and operate in a foreign market. For instance, the prevalence of current mercantilist view on trade exhibited by some governments is leading up to the trade war and under such circumstance, nonmarket activities of foreign firms in a host country is not fading but gaining more importance. Although many scholarly studies attempt to better understand various types of nonmarket strategies firms use and which of these strategies lead to achieve positive outcomes, our understanding of the topic is far from complete.

Thus, my dissertation, which is a three-essay empirical research, attempts to fill the gap in our knowledge, especially on (1) what drives firms to engage in nonmarket and political activities and (2) what strategies enable firms to achieve positive outcomes through their nonmarket activities. In the first chapter, I carefully examine the relationship between corruption and lobbying behaviors. In the second and third chapter, I show the strategic heterogeneity of firms and how such strategic heterogeneity helps firms to achieve positive economic outcomes.

To conduct this research, I put a lot of effort in building unique datasets; my dissertation intends to overcome the limitations of prior studies by conducting more systematic and reliable analyses by constructing unique datasets. These datasets include (1) US federal lobbying and campaign contribution data, (2) country level institutional, geographic, and economic variables from various sources, and (3) US defense contracts data from the Department of Defense (DoD). In the following sections, I summarize each chapter and discuss the conclusion.

## Overview of Essays

**Essay 1 – Do You Lobby Because You Are More Corrupted? No, You Lobby Because It's Legitimate: Evidence from Foreign Firm Lobbying in the US**

The first chapter looks at the relationship between corruption and lobbying. People tend to think that corruption and lobbying are substitutes. This notion is probably driven by a number of recent lobbying scandals and by the negative impression that money can buy politics. In this chapter, Jordan Siegel at University of Michigan and I examine the relationship between corruption and lobbying behaviors of firms using foreign firm lobbying and other political behaviors data in the United States. We find that the degree of corruption is negatively associated with the degree of lobbying.

Corruption as a social norm is deeply ingrained in a society, which affects behaviors of people and organizations embedded in the society. Because of its persistent effect and magnitude, many scholars have paid a lot of attention on corruption. Existing literature on corruption, in general, argues that corruption and lobbying are highly and positively associated, which implies that any form of corruption may substitute any form of lobbying. In other words, corruption and lobbying are seen as the same thing, which also aligns with the general perception of lobbying. However, the definition widely accepted and used in the current political science literature is different from how the corruption literature defines lobbying. In principle, current political science literature defines lobbying as an information exchange between political players and interest groups (de Figueiredo and Richter 2014). In more developed countries such as the US, lobbying is a legitimate way of communication, playing a key role in policy making (Hall and Deardorff 2006). As such, lobbying is distinct from corruption, which typically involves illegal or unethical behaviors that are penalized and punished by the law or public if detected (Ades and Di Tella 1999; Shleifer and Vishny 1993).

Thus, in this study, we argue that lobbying is not a substitute for corruption; rather, in more developed economies, lobbying is a legitimate way of communication in policy making. To test this hypothesis, we focused on lobbying behaviors of foreign firms from multiple countries in the US. If lobbying was in fact a substitute for corrupted behaviors, we expected to see countries suffering from high levels of corruption to engage in more lobbying. Empirically, we used a novel US federal lobbying dataset to analyze the relationship between corruption and lobbying at a country level from 1998 to 2012.

> *"Lobbying is not a substitute for corruption; rather, in more developed economies, lobbying is a legitimate way of communication in policy making.*

The results confirm our main prediction that there is a positive relationship between lobbying spending and instrumented corruption measures is strongly supported. More specifically, the results show that countries suffering from less corruption (higher instrumented value of corruption index) are more likely to spend more on lobbying. In order to confirm the results, we regressed multiple other lobbying intensity variables such as number of firms lobbied, average number of congressional issues addressed on three instrumented corruption measures. The results still strongly support our prediction that firms from countries suffering less from corruption are more likely to engage in lobbying. In sum, this study shows that one of the most important drivers of lobbying is home country institution, particularly the degree of corruption.

Furthermore, this study provides important implications to policymakers. Contrary to the general notion that corruption and lobbying are substitutes, this study clearly illustrates that lobbying might not be a substitute for corruption but they work in distinct ways. Particularly, strict disclosure of political activities and presence of a strong enforcement and monitoring mechanism could make firms' political activities more open and transparent, which could create positive externalities. Thus, this study may be particularly useful for policymakers in countries suffering from corruption who desire to eradicate corruption.

**Essay 2 – Let's Talk about the Contract over Coffee and Donuts: Exploring the Bi-Directionality of Agency Embeddedness in US Government Contracting**

The second chapter, with Shon Hiatt at University of Southern California, focuses attention on one of the mechanisms that could potentially drive positive economic outcomes of nonmarket activities. While most research on business–government relations has focused on firm interactions with political officials, scholars have recently recognized the importance of studying relations between businesses and the administrative state, and the possible ways that firms can influence policy interpretation and execution (Holburn & Vanden Bergh, 2008). Particularly, from our interviews with multiple defense contractors, we realized that continuous interaction and relationship building with officials in local agencies, which could be as casual as conversations over coffee and donuts, help firms to better understand the needs of these officials. Thus, in the second chapter, we seek to understand agency embeddedness, a mechanism through which firms can influence administrative decisions and obtain positive firm results.

Government agencies heavily rely on outside stakeholders including policymakers for necessary resources and discretion (Carpenter, 2001). A key condition of this support is the agency's effectiveness in implementing policy: the more effective an administrative agency is, the more discretion from legislative oversight and resources it can accrue (Hiatt & Park, 2013). One important way in which agencies can increase their effectiveness is through agency embeddedness – defined as an agency's "connection with the surrounding social structure" (Evans, 1995: 50). Scholars argue that agency embeddedness positively increases the administrative state's capacity to effectively implement policy and interpret laws by providing government officials with information about the firms they regulate (Evans, 1995).

While most of the research focuses on how embeddedness benefits state agencies, we suggest that the effects of agency embeddedness can be bidirectional and that firms can also be affected by and benefit from their interactions with agency officials. Specifically, we argue that firms' geographic proximity to agency decision makers can enhance agency embeddedness by facilitating interpersonal interactions between firms and agency (Tilcsik & Marquis, 2013). Studies on organizational geography and community have demonstrated that geographic proximity plays a significant role in increasing interpersonal interactions and relationships (Marquis & Battilana, 2009). Thus, we propose that the closer the distance between firms and government agencies, the greater the agency embeddedness and hence ability of firms to secure favorable administrative outcomes. Empirically, we explored US defense contract awards from 1994 through 2006. Exploring defense contract awards provides an ideal empirical setting to understand the impact of geographic proximity because contracts are awarded by a number of contracting offices at different hierarchical levels of the government and with varying levels of decision-making discretion. Variation in local agency discretion allowed us to examine the boundary conditions of agency embeddedness.

The statistical results confirm that when the distance between the firm and the contracting office is small, firms are more likely to win larger contract amounts, and this effect is moderated by types of contracts made. In sum, this study shows that firms and state agencies influence each other and such interaction can be promoted when there are lower barriers to communicate and build trust. In particular, such strategy is more attractive and effective for domestic firms because foreign firms are not as socially embedded as domestic firms, which attests to the liability of foreignness (Hymer, 1960/1976; Zaheer, 1995). The results also have important implications as regards foreign firms' nonmarket activities in a host country. One of the ways that foreign firms can overcome the liability of foreignness is to possess transferred competitive advantages from the home country, such as knowledge. However, this would be difficult, particularly in cases where industry regulations are high that prevents home country advantages to be transferred. Thus, the results of the second chapter pose an important question about what strategies enable foreign subsidiaries in a host country to overcome such disadvantages. Building on these findings, the last chapter examines the nonmarket strategies of foreign firms that could alleviate the effect of liability of foreignness ultimately to achieve positive economic outcomes.

**Essay 3 – Not Sure about Your Capability? No Worries. You Can Buy It: US Defense Contracts and the Lobbying Strategies of Foreign MNEs**

Building on the second chapter, the final chapter looks at what strategic heterogeneity allows foreign firms to achieve positive economic outcomes with inherent liability. Literature on political capital unanimously argues that political capital is critical to achieve better nonmarket performance (Siegel, 2007). Assuming that foreign firms are disadvantaged because of their liability of foreignness in a host country (Hymer, 1960/1976; Zaheer, 1995), it is highly likely that foreign firms might not possess enough political capital they need to execute effective nonmarket strategies. This raises questions about (1) how foreign firms engage in nonmarket activities with inherent disadvantages such as lack of political capital, and (2) whether they achieve their intended nonmarket goals.

Hence, in this paper, I examine these questions by looking at the effect of firm boundary decision in hiring lobbyists on defense contract outcome. I propose that liability of foreignness (Hymer, 1960/1976; Zaheer, 1995) creates heterogeneity in political capital for foreign firms in engaging in nonmarket activities. Due to the characteristics of political capital which can neither be easily transferred from the home country nor built up in the host country comparable to that of domestic firms, I argue that relying on outside political capital manifested as the knowledge/expertise of outside lobbyists and political connections would lead foreign firms to achieve better outcomes. Namely, although foreign firms suffer from liability of foreignness and this penalizes them to sustain the same degree of political capital inside a firm, foreign firms would be able to effectively address their nonmarket interests through outside political capital.

Empirically, I examined US federal defense contract awards from 1998 through 2006, particularly contracts to purchase weapons and related systems. Decisions on weapons purchases are mainly driven by elected politicians and the upper echelon of the DoD, a scenario that makes lobbying an important nonmarket strategy for defense contractors. Moreover, the defense industry is domestically driven and resistant to foreign firms; thus foreign defense contractors have difficulty penetrating the market. This empirical setting is ideal for assessing both the effectiveness of lobbying of foreign-owned defense contractors and its underlying mechanisms. The statistical analyses support that foreign defense contractors gain higher government defense contract amounts when they hire outside lobbyists. Specifically, foreign defense contractors enjoy better outcomes when they hire more experienced lobbyists and lobbying firms with more political connections, complementing their lack of institutional knowledge and less social embeddedness.

To summarize, this study shows that foreign firms can achieve positive outcomes despite suffering from the liability of foreignness. As pointed out earlier, current literature argues that foreign MNEs must possess certain competitive advantages to overcome the liability of foreignness in order to compete against domestic firms (Hymer, 1960/1976; Zaheer, 1995). However, certain industry characteristics make it more difficult for foreign MNEs to gain competitive advantages over domestic firms. The results of this study indicate that in such cases, foreign MNEs might want to supplement their insufficient resources and capabilities by relying on outside firms rather than just relying on their own competitiveness. This finding contributes to an underexplored but important area of international business, delineating how foreign firms can achieve positive outcomes through nonmarket strategy.

## Conclusion

Governments not only as rule makers but also as game players increasingly influence the activities of firms by controlling economic and regulatory benefits. Understandably, the role of governments are most salient to foreign firms in a host country. Nevertheless, foreign firms are no longer passive observers but are becoming more active game players in business–government relations. However, our understanding on firms' nonmarket strategies and the outcome of those activities, particularly with regards to foreign firms, is limited at most. Thus, the three essays in my doctoral study take an important step towards better understanding nonmarket behaviors of firms, particularly foreign MNEs in a host country context. Using multiple large-scale datasets and rigorous empirical analyses, I identify institutional drivers of political activities and demonstrate the outcomes of such activities. I am confident that my dissertation study sheds more light on a relatively underexplored area of research where nonmarket strategy and international business intersect. Nevertheless, many questions remain as regards the phenomenon of foreign MNEs' nonmarket activities. Hence, it is my goal to expand our knowledge and to contribute to the international business field by continuing rigorous theoretical and empirical research on this area.

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