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Subnational Institutions and Location Choice of Emerging Market Firms

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ABSTRACT

I examine how subnational institutions of emerging markets affect the location choice of emerging market firms. I argue that the weak institutions in emerging markets push firms to acquire the skills needed for survival in unfavorable institutional environments. When they start their international venturing, such knowledge, skills, and capabilities will become their unique advantage, which makes them more resilient to red tape, nepotism, and corruption in the host countries. Using a sample of 143 outward FDI events of Chinese multinationals, I test the relationship between subnational institutions at home and firm propensity to enter a target market with weak institutional systems and found robust empirical support for the use of different estimation strategies. Further, my results demonstrate that the effect of subnational institutions at home on location choice is more pronounced in private enterprises compared to state-owned enterprises. This study reveals the importance of home country effects in location choice research and tests empirically the existence of institutional advantage.

1. Introduction

Emerging markets have seen impressive development in recent years. In 2000, developed countries accounted for 80.7% of the global outward FDI and developing countries accounted for only 18.8% of the global total, while in 2013, the global outward FDI shares for the developed and developing countries shifted to 39% and 53.6%, respectively (UNCTAD). The development of emerging economies is also well documented in current management research. An increasing number of articles have discussed the motivation (e.g., Aulakh, 2007; Estrin et al., 2017; Luo and Tung, 2007; Madhok and Keyhani, 2012), location choice (e.g., Ramasamy et al., 2012), and entry mode of emerging market multinationals (e.g., Madhok and Keyhani, 2012; Peng, 2012). Across the literature is debated whether the emerging market firms follow the same internationalization path as their predecessors from developed countries did decades ago (e.g., Dunning et al., 2008; Hennart, 2012; Narula, 2012; Ramamurti, 2012). For this reason, more work needs to be done to theorize the internationalization patterns of emerging market firms and explain the unique traits that characterize the international expansion of emerging firms. It has been suggested that new theories be adapted and new paradigms be forged in order to accomplish this (Cuervo-Cazurra, 2012; Luo and Tung, 2007; Narula, 2012).

One phenomenon that characterizes the internationalization patterns of emerging market firms are their unique location decisions. Unfavorable institutional environments, in which corruption, red tape, and nepotism are pervasive, are recognized as risky for outward FDI and will decrease the willingness of multinationals to invest overseas (Cuervo-Cazurra, 2006, 2008a, 2008b; Habib and Zurawicki, 2002). However, prior research has found that some emerging market firms prefer to invest in less developed countries with chronically weak institutions (Morck et al., 2008; Peng, 2012). The allure of emerging market firms for less-developed host countries also arouses substantial media attention, some of which regards the swarm of capital into less developed countries from

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emerging economies as “a threat of neocolonialism” (e.g., Grammaticas, 2012; Wagner and Cafiero, 2013; Poplak, 2016).

The enthusiasm of emerging market firms to enter and operate in less developed countries may be explained by their distinctive motivations. Researchers argue that emerging market firms place a greater emphasis on resource-seeking behavior, which includes preempting market niches, acquiring strategic assets, and learning implicit knowledge, than on resource-exploitation in their internationalization strategies (Aulakh, 2007; Luo and Tung, 2007; Morck et al., 2008; Peng, 2012; Yoo and Reimann, 2017). If a host country occupies some location-specific resources that are unavailable elsewhere, emerging market firms may break into the country using fast acquisitions, irrespective of the institutional environment of the market being entered (Madhok and Keyhani, 2012; Peng, 2012).

Another explanation is that emerging market firms attain advantages from the special institutional environment at home, which makes them adaptable to host countries where institutions are chronically weak (Mathews, 2006). Since emerging markets generally have weak institutions and severe corruption, firms from emerging markets are accustomed to an inferior institutional environment which allows them to develop special capabilities that enable them to operate in uncertain and risky settings. When emerging market firms initiate their business in a destination with weak institutions, the special capabilities they have developed at home can facilitate the adaptation to the uncertain environment and shield them from negative impacts that stem from the institutional voids in the host country. This logic is consistent with current research on institutional advantage, which argues that under certain circumstances, the institutional context from which a focal firm originates could become a source of comparative advantage exclusively enjoyed by firms that operate in that type of institutional setting (Ahuja and Yayavaram, 2011; Martin, 2014; Mathews, 2006).

Not only does the special institutional environment in emerging markets nourish emerging market firms' special capabilities that incentivize them to invest in corrupt host countries, the prominent differences in subnational institutions in different regions where emerging market firms originated may induce heterogeneous location choices when they go overseas. Previous research finds that the variation of subnational institutions is larger in emerging markets than in developed countries (Chan et al., 2010; Schlevogt, 2001; Shi et al., 2012). While such variation is salient in emerging market contexts, it is not until recently that international management literature acknowledges the effects of subnational institutions and analyzes how such within-country differences impact the entry strategies of multinationals (Shi et al., 2012). Moreover, little research has examined how subnational institutions in a home country affects the internationalization of emerging market firms. Given that home country institutions shape the internationalization patterns of multinationals (Geleilate et al., 2016; Witt and Lewin, 2007), a reasonable corollary is that subnational institutions at home, if varying significantly across the country, will trigger heterogeneous location choices of multinationals.

Following the institutional advantage logic and acknowledging the substantial differences in regional institutions in emerging markets, I argue that emerging market firms from different regions may accumulate various levels of institutional advantage and have heterogeneous location choices when they begin their international venturing. Specifically, emerging market firms from a region with weak institutions are more likely to enter a relatively corrupt country. Compared to their counterparts from less corrupt regions, firms growing up in regions rife with corruption have greater and richer experience in operating under instability and risk. When these firms start internationalization, such experience provides them with an institutional advantage (Martin, 2014, p. 57) which broadens their scope of location choices. Because the acquisition of institutional advantage requires repeated learning and imprinting at home (Holburn and Zelner, 2010; Oliver, 1997; Peng et al., 2009; Peng et al., 2008), and heavily relies on the social context in which organizations operate, it is unique to a subset of emerging market firms that originate from hostile institutional environments (Argote and Miron-Spektor, 2011; Oliver, 1991, 1997; Peng et al., 2009).

Nevertheless, institutional advantage is not the only approach for overcoming the negative impacts of deficient institutional environments. Government involvement could be another mechanism that induces the entry of emerging market firms in destinations with unfavorable institutions (Guimón et al., in press). Emerging market governments are often deeply involved in the outward FDI of domestic firms (Cui and Jiang, 2012; Luo et al., 2010; Wang et al., 2012a). If a home country government provides varied forms of support (usually monetary and policy supports) toward the outward FDI of emerging market firms, they will be more motivated to invest overseas, even if the institutional environment in the host country is insecure and firms do not possess enough skills to successfully operate in the host country.

The main contributions of this study are threefold. First, it takes a closer look at the complex and unbalanced institutional systems in emerging economies. Previous research argues that multinationals may have comparative competitive advantages in some cases (Martin, 2014). To the best of my knowledge this is the first empirical paper to examine the conditions under which emerging market firms obtain such advantage (in terms of institutional advantage) and how this advantage shapes their location choices in outward FDI. Using organizational learning literature, I argue that institutional advantage is the result of institution-embedded learning processes that are context-specific. Once firms acquire such advantage, they utilize it elsewhere. The empirical results support my arguments on the importance of institutional advantage to emerging market firms (Ahuja and Yayavaram, 2011; Hennart, 2012; Martin, 2014).

Second, this paper illustrates the key role of home country government in emerging market research (Luo and Wang, 2012). State ownership, as an ownership arrangement, is widely used in emerging markets, yet previous studies pay little attention to state ownership due to its rarity in developed countries. Along with the recent rise of emerging markets, how state ownership navigates FDI of emerging market firms requires is worthy of deeper examination due to its prevalence in the emerging markets (Xia et al., 2014).

Lastly, this study examines the boundary condition of institutional advantage. I find that prolonged exposure to deficient institutional environments strengthens the institutional advantage of firms, and that private enterprises are more likely to gain institutional advantage than state-owned enterprises. This implies that government involvement may act as an alternative buffering mechanism that isolates the negative influence of corruption.

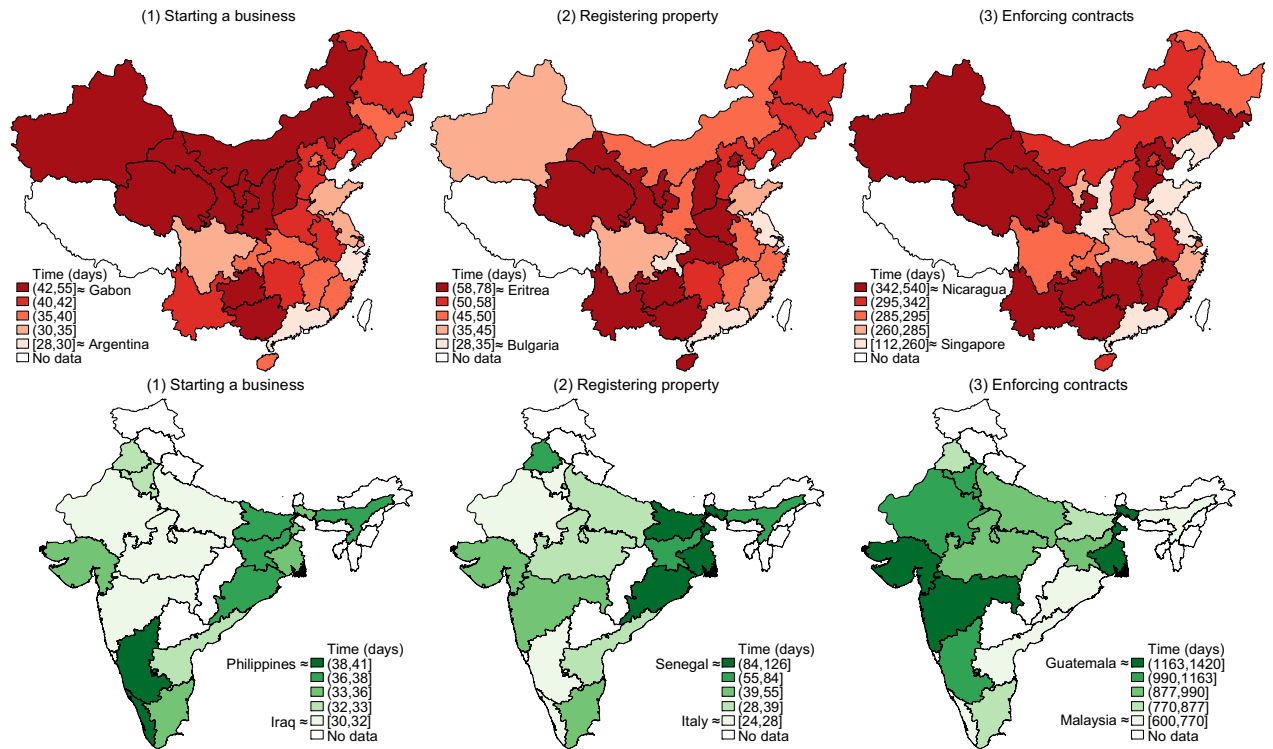


Fig. 1. Subnational differences in business regulatory environment in China and India.

Source: Doing Business in China 2008 Report; Doing Business 2008 report; Doing Business in India 2009 Report; Doing Business 2009 report.

2. Literature review and hypotheses

2.1. Emerging market

Defined as low-income, rapid-growth countries using economic liberalization as their primary engine of growth (Hoskisson et al., 2000), emerging markets differ significantly from developed countries in terms of their institutional environment. Researchers pointed out that emerging markets tend to lack strong legal frameworks and market-supporting institutions (Meyer et al., 2009; Peng et al., 2008), making their market systems vulnerable to graft, bribery, nepotism, and red-tape. Additionally, the institutional systems in emerging markets vary in their level of development at the subnational level. Within the same nation, some regions have developed relatively strong institutional systems, whereas other regions are plagued with institutional weaknesses (Chan et al., 2010). The gaps in economic institutions between different subnational regions are severe across the world (e.g., Chung and Alcácer, 2002), yet they are more prominent in the emerging market contexts (Chan et al., 2010). Results from a series of surveys conducted by World Bank that compare business regulations around the world showed that China and India, two typical emerging economies, have both an underdeveloped institutional framework at the country level and highly unbalanced institutional systems across regions. Fig. 1 visualizes the survey data and yields some interesting results. First, in China, the coastal regions are much more efficient than the inland provinces in supporting local businesses, as evidenced by less time to start a business (including obtaining licenses and permits, completing required notifications, etc.), smooth property registration processes, and timely investor protection (much less time in enforcing contracts); second, in comparing regions in China to other countries, regions with weakest institutional environment are equivalent to other developing countries such as Gabon, Eritrea, and Nicaragua, while the regions with strongest institutions are comparable to middle-income or developed nations such as Argentina, Bulgaria, and Singapore. Third, the characteristics of institutional systems we witness in China, namely underdeveloped overall and varied across regions, can also be observed in the institutional systems in India, though the socio-cultural and geographical environment is totally different there.

The notable differences among subnational regions imply that decision makers need to accommodate subnational factors in their decision model (Meyer and Nguyen, 2005; Shi et al., 2012) since they may produce differing behavioral patterns and strategic decisions of emerging market firms. At the national level, emerging market firms face pervasive red tape, nepotism, and corruption. To survive in such an institutional environment, they must learn skills of cooperating with inefficient bureaucratic systems and acquiring scarce resources. They must also learn to successfully navigate corruption by avoiding and withstanding corruption or alternatively, by participating effectively in that corruption. At the regional level, because of the wide disparity in institutional environments across regions, firms from regions with weaker institutional systems are able to learn more knowledge, skills, and capabilities regarding doing business in underdeveloped markets. When they begin to internationalize, such capabilities of surviving

in a “hostile” environment could become their unique competitive advantage (Cuervo-Cazurra and Genc, 2008). The potential institutional advantage experienced by of emerging market helps explain the pattern in the global economy in which emerging economies are playing increasingly important roles.

Drawing from the organizational learning literature, I conceptualize emerging market firms' accumulation of institutional advantage as a learning process. By connecting organizational learning of emerging market firms to the specific contexts from which they originate, I explain why multinationals from emerging economies possess an institutional advantage compared to their competitors from developed economies. Furthermore, I incorporate subnational institutions into my discussion to explain how subnational differences induce different location choices of emerging market firms.

2.2. Institution-embedded learning and institutional advantage

Institutions are “rules of the game” in a society (North, 1990, p.7). On the macro level, institutions shape the way societies evolve through time (North, 1990); on the micro level, they “provide stability and meaning to social activities” (Scott, 1995, p.33). Given the ubiquity of institutions in human society, organizations can never be exempt from institutional pressures. Almost all firm-level activities, such as resource selection, capability building, corporate reconstruction, and organizational adaptation and change are embedded in social contexts (Oliver, 1991, 1997; Peng et al., 2009). Institutional pressures shape organizational objectives. In classical economic models, firms pursue economic efficiency quantified by economic profits; but in the real world, firms attempt to achieve both organizational efficiency and legitimacy (Scott and Davis, 2007). Researchers summarize the institutional embeddedness of organizational behavior with the following proposition: “managers and firms rationally pursue their interests and make strategic choices within the formal and informal constraints in a given institutional framework (Peng et al., 200, p.679)”.

Organizational learning is the process of improving actions through better knowledge and understanding (Fiol and Lyles, 1985). As an organization-level activity, learning begins with first-hand experiences of organizations and ends with institutionalized routines or procedures (Crossan et al., 1999; Shrivastava, 1983). Since the entire learning process, beginning with intuiting and interpreting to institutionalizing and continuing onto an interior knowledge transition, takes place in a specific social context (Argote and Miron-Spektor, 2011; Crossan et al., 1999; Levitt and March, 1988), the social context affects what and how much organizations learn (Johns, 2006).

As key components of a social context (North, 1990), institutions greatly affect the learning activities of organizations. Organizations learn in a specific institutional setting (Lam, 2000), follow the examples of legitimate organizations (DiMaggio and Powell, 1983), and acquire socially accepted knowledge. In some cases, the objective of learning per se is to obtain institution-related knowledge. When the learning process is inextricably linked to the institutional environment, the focal organization embeds itself in the institutional environment.

Emerging market firms' accumulation of institutional advantage is a typical institution-embedded learning process. A firm has an institutional advantage when “its strategy, featuring distinctive resources and activities, is enabled by its interactions with the institutional environment and generates economic value in excess of its competitors (Martin, 2014, p. 59)”. Because emerging market firms consistently face unfavorable institutions in their homeland, they must develop proper means to coexist with such an institutional environment. Proper means includes, but is not limited to, political strategy (e.g., Hillman and Hitt, 1999), political capability (e.g., Holburn and Zelner, 2010), and political behavior (e.g., Boddewyn and Brewer, 1994). These political strategies, capabilities, and behaviors, help emerging market firms withstand the negative impacts of local institutions, such as deficiency of formal institutions, unequal distribution of scarce resources, red tape, and corruption. When they start to internationalize, their experience in coping with unfavorable institutions will become these new multinationals' distinctive competitive advantage that facilitates their overseas operations (Martin, 2014).

Since emerging markets have underdeveloped institutional frameworks and subnational institutions that differ widely across distinct regions (Meyer and Nguyen, 2005; Nguyen et al., 2013; Schlegvogt, 2001; Shi et al., 2012; also see Fig. 1), emerging market firms vary in their ability to accumulate institutional advantage. Regarding outward FDI, firms from regions with less developed subnational institutions benefit from institution-embedded learning, and therefore are more likely to enter locations with equivalent underdeveloped institutions. For firms from regions with relatively strong subnational institutions, it is unnecessary to learn those context-specific skills, and thus, they acquire less institutional advantage and are less likely to enter destinations with incomplete institutional frameworks. This leads to the following hypothesis:

Hypothesis 1a. (H1a): The weaker the subnational institutions in the region where an emerging market firm originates from, the more likely this firm later enters a host country with weak institutional systems.

H1a predicts the general superior adaptability of emerging market firms based on an institutional advantage logic. Nevertheless, institutional system is an inclusive concept comprised of distinct second-order mechanisms such as procedures, regulations, culture, and conventions (North, 1990), and firms can accumulate different types of institutional advantages due to disparate formal and informal mechanisms they were previously exposed to. For example, obtaining credit remains a significant obstacle for Chinese firms (The World Bank Group, 2008), especially for start-ups lacking immovables such as collateral or non-SOEs not connected to local banks. This issue can largely be attributed to the registration administration in China: on the one hand, the registration of collateral is the prerequisite for credit; on the other, the registration administration is highly fragmented, requiring the involvement with a dozen agencies to finish all procedures (The World Bank Group, 2008). Moreover, some provinces have even more complicated registration processes, making financial services scarce and inaccessible to firms in those regions. As a result, local firms have to pull themselves up by their bootstraps: business owners may be effective at obtaining financial support through their social relationships (e.g.,

relatives and friends), or adopt lean manufacturing for cost saving. Whatever approaches they choose, these firms obtain the institutional advantage of surviving under strict resource constraints, and will be more effective in host countries in which financial markets are immature compared to firms that have adequate financial assistance at home.

Because of the multiplicity of institutional systems, testing all components of institutional systems would be very difficult. In the results section, I examine the institutional advantage argument using an index measuring the overall quality of local institutions. In addition, I also make some exploratory analysis on different types of institutional advantages using other indicators that measure the quality of subnational institutions in various aspects.

Another notable issue pertains to the effectiveness of institution-embedded learning that allows for the accumulation of institutional advantage. Organizational learning involves substantial physical investment and long-term commitment. An extensive body of literature on learning curves has found that organizational learning is a function of time and cumulative output (Adler and Clark, 1991; Argote and Miron-Spektor, 2011; Lieberman, 1987; Pisano et al., 2001, to name a few): the deeper that firms are involved in production (in terms of long duration and large volume of output), the lower will be their cost per unit product (namely higher productivity). This argument is not only supported by empirical studies from manufacturing industries (e.g., Adler and Clark, 1991; Hatch and Mowery, 1998), but also finds support in non-manufacturing settings (e.g., Pisano et al., 2001). By modeling the accumulation of institutional advantage as an institution-embedded learning process, my theoretical framework inherits the argument that time acts as a catalyst for learning. Although subnational institutions at home trigger emerging market firms' accumulation of institutional advantage, they will not obtain sufficient capabilities until they intensively interact with the local institutions. Therefore, the duration that emerging market firms immerse themselves in local institutions will facilitate their acquisition of institutional advantage.

Hypothesis 1b. (H1b): The duration an emerging market firm stays in a region moderates the relationship between subnational institutions and its location choice, such that firms with a longer duration in a region with weak subnational institutions are the most likely to enter a country with weak institutional systems.

2.3. Government involvement

Besides institutional advantage, other factors also shape the internationalization of emerging market firms. Emerging market governments are promoting outward FDI of domestic firms (Buckley et al., 2007; Luo et al., 2010). On the macro level, they launch public policies such as tax deductions, low-interest loan, and export subsidies (Luo et al., 2010); on the micro level, governments directly shape the internationalization of state-owned enterprises (SOEs) by changing their preferences and goals (Wang et al., 2012a; Xia et al., 2014). For those emerging market firms that are endorsed by the government, they receive more public resources that could be utilized in internationalization once they decide to invest overseas (Boddewyn and Brewer, 1994; Wang et al., 2012b).

Government involvement also helps during the internationalization of emerging market firms. Wang et al. (2012a) argue that higher level of government affiliation is a symbol of greater status that reinforces trustworthiness and reduces uncertainty in international business. Rui and Yip (2008) find in a case study that SOEs received stronger support from home country government than non-SOEs when they attempted to acquire foreign firms. Government involvement reduces the risks and uncertainties emerging market firms might encounter during their internationalization.

More importantly, government involvement is different from the institutional advantage logic in two aspects. First, government involvement is exogenous for emerging market firms as compared to the accumulation of institutional advantage, which is an endogenous process. In other words, SOEs deterministically receive stronger support than non-SOEs in internationalization. Second, in contrast to institutional advantage which is gained only after repeatedly learning process and requests substantial costs (Cohen and Levinthal, 1989), government involvement does not require learning on the part of emerging market firms.

Therefore, I argue that government involvement is an independent mechanism in addition to the institutional advantage that drives the location choice of emerging market firms. Compared to private firms, SOEs are less sensitive to the adverse conditions in the host country because they receive added support from the home country government.

Hypothesis 2a. (H2a): Emerging market firms that are SOEs are more likely to enter a host country with weak institutional systems than non-SOEs.

2.4. Boundary condition of learning

As previously mentioned, organizational learning is embedded in the social context under which organizations operate (Argote and Miron-Spektor, 2011). Thus, social context is a *sufficient* condition to acquire context-specific knowledge. Organizations accumulate the capabilities of surviving in an unfavorable institutional environment only if they are in a social context surrounded by unequal distribution of resources, red tape, nepotism, and rife corruption. After they obtain such institutional advantage, their knowledge of bootstrapping (i.e., achieving goals by themselves and using minimal resources), interacting with inefficient government, and navigating corruption is beneficial not only in the home country but also in the targeted markets with similar institutional weaknesses. This logic underlines H1a.

However, social context is not a *necessary* condition to acquire context-specific knowledge. Being in a region with weak subnational institutions does not necessitate the acquisition of institutional advantage. If organizations can insulate themselves from the negative impacts of local institutions through other channels, they might be less motivated to conduct institution-embedded learning

as it consumes substantial organizational resources. I have discussed the direct effect of government involvement in shifting the internationalization patterns of emerging market firms. Here I argue that government involvement also indirectly affects the location choice of emerging market firms by weakening the motivation to engage in institution-embedded learning. On the one hand, competing for scarce resources (e.g., getting credit in China) is an important scenario motivating institution-imbedded learning. Since SOEs often need not join in the competition for public resources, they are less exposed to the dark side of institutional frameworks in emerging markets and as a result, learn less from it. On the other hand, SOEs could appeal to their ultimate stakeholder, the government, when they get unfair treatment in the market. As they solve the conundrum by turning the government into their agents (Boddewyn and Brewer, 1994), they become immune to the negative impacts of local institutions.

Therefore, the relationship between subnational institutions and firm propensity of investing in a destination with weak institutional systems is not only moderated by the duration of emerging market firms in the home country, but is also contingent on the extent to which the home country government endorses these firms (Luo et al., 2010). While the propensity to enter a relatively corrupt country rises for private enterprises coming from regions with weak institutional systems and who have remained at home for a longer duration, it varies little for SOEs from home-country regions with weak as opposed to strong subnational institutions or SOEs having a longer as opposed to shorter duration in those regions. I use a three-dimension model to visualize these differences between private enterprises and SOEs (see Fig. 3). Subnational institutions are placed on the X axis, duration on the Y axis, and location propensity on the Z axis. Based on the argument that SOEs rely less on institution-embedded learning, the flat line composed by simulated private enterprises is steeper than the flat formed by simulated SOEs.

Hypothesis 2b. (H2b): Government involvement weakens the moderating relationship among subnational institutions, duration, and location choice, such that SOEs' location choice varies less across different subnational institutions and different home-country durations.

3. Setting, data, and measures

3.1. Setting and sample

I chose China as my research context for three reasons. First, China's outward FDI flows reached 107.84 billion U.S. dollars in 2013, ranking in 3rd after the United States and Japan (Ministry of Commerce of People's Republic of China, 2014). China's outward FDI constitutes half of the total amount from BRICS countries (Brazil, Russia, India, China, and South Africa) in 2013 (UNCTAD), demonstrating China's prominent and representative position as an emerging economy in the global economy. Secondly, Chinese government has historically been tightly involved in SOEs' operations, and the SOE reform in the 1990s has given SOEs enormous power in Chinese economy. (Ralston et al., 2006, p.825). Considering that the largest sources of Chinese outward FDI are SOEs (Morck et al., 2008), China provides a superb context to test how government involvement affects firm's internationalization. Lastly, my exploratory analysis using web scraping shows that China is an excellent context for this research. I extracted information on all permissions of outward FDI between 1978 and 2015 (as of May 25) from the database of Ministry of Commerce of the People's Republic of China (MOC). The web scrapping yields 37,675 results and the density plot is shown in Fig. 2. From Fig. 2 I find that: first, before 1999, when the government-led "go global" initiative was instigated, few Chinese firms invested overseas and acquired international experience (Buckley et al., 2007); and second, after 2010, a large number of emerging market firms have accumulated abundant international experience and they rely less on their knowledge and resources built domestically to successfully enter a host country (See Fig. 2). Limiting the observation window to 2000 through 2010 when most emerging market firms started their international venturing without much overseas experiences, this study to a large extent controls the confounding effects of international

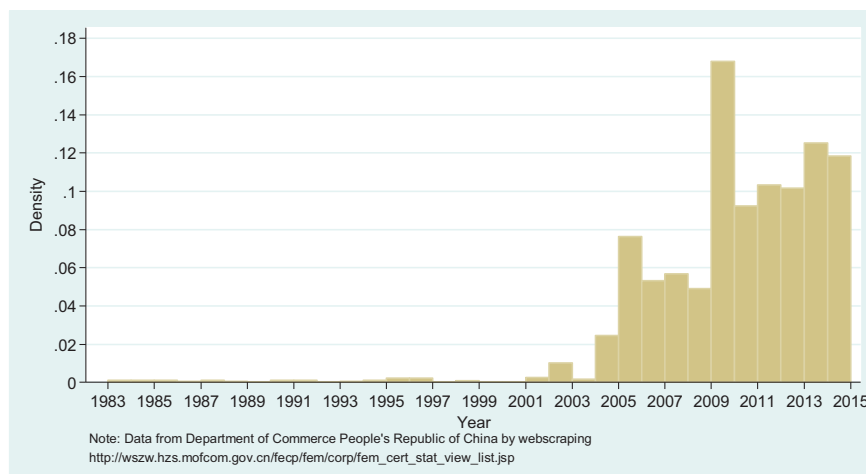


Fig. 2. The amount of outward FDI from China, from 1983 to May 25, 2015.

experience in emerging market firms' location decisions.

The data are from Bureau van Dijk's Zephyr database. Zephyr is a major merger and acquisition (M&A) database widely used by strategy scholars (e.g., [Arora and Nandkumar, 2012](#); [Bauer and Matzler, 2014](#); [Paeleman and Vanacker, 2015](#)). I identify outward FDI from China by listing all cross-border M&A cases launched by Chinese companies between 2000 and 2009. M&A cases completed by individuals or by non-manufacturing firms are dropped. After this procedure, I identify 275 cross-border deals carried out by 218 firms. Some firms independently finished multiple deals, while other firms only jointly launched one deal during this time. Among the 275 observations, roughly half the observations pertain to joint ventures (JV) while the other half pertain to M&As. The M&A data capture foreign firms become the wholly owned subsidiaries (WOS) of Chinese firms.

A problem in this sample is that we could not observe the cases in which emerging market firms go overseas via greenfield investment. Previous scholars have noticed such an issue when they utilized M&A databases in conducting internationalization studies (e.g., [Li et al., 2012](#)), but they considered it not to be a major issue in China's case since M&A was allegedly the primary investment mode after 2000 ([Li et al., 2012](#)). A recent review by [Peng \(2012\)](#) has the similar opinion that that Chinese multinationals nowadays use M&A to rapidly enter host countries. To verify their argument, I compare the cross-border M&A cases compiled by Zephyr to the list of outward FDI of Chinese firms released by the ministry of commerce (MOC). The latter dataset is an authentic list of all Chinese firms that go abroad. The coefficient between the annual number of firms going abroad from MOC list and the number of firms compiled by Zephyr database is 0.676 ($p = 0.03$). Since the former dataset includes firms from all sectors and my sample from Zephyr only includes manufacturing companies (SIC code from 20 to 39), such correlation coefficient is satisfactory. I therefore believe that Zephyr as my data source is appropriate in this study. I removed observations of firms that are non-listed or have never disclosed their information before, resulting in my final sample consisting of 143 observations.

3.2. Variables

3.2.1. Dependent variable

The dependent variable is a dichotomous variable that captures the location of emerging market firms in an acquisition. It receives a value of one if the host country is a relatively corrupt country and zero otherwise. To build the location variable, I use the control of corruption index, a sub-index of World Governance Indicators (WGI) published annually by World Bank since 1996. Compared to other corruption indices, such as the Corruption Perception Index, WGI are comparable both cross-sectionally and longitudinally, rendering it more suitable for my study in which investment incidents range from 2000 to 2009. The index has been used by many scholars (e.g., [Cuervo-Cazurra, 2006](#); [Weitzel and Berns, 2006](#)). It ranges from -2.5 to 2.5 . A smaller number of the index implies more public power is exercised for private gains. For each year, I split the control of corruption index by its median value. The group of countries with lower control of corruption index receives the value of one. Between 1996 and 2002, the control of corruption index was compiled on a biannual basis. I use univariate imputation method to compute the corruption index in 2001, which I then split at its median value. The code for imputation can be provided upon request.

Note that I am using a corruption index to approximate the overall quality of institutional systems in host countries. Although corruption is closely related to the institutional quality in a host country, it is undeniable that corruption is only a subset of local institutions and does not draw a complete picture of host country institutions. To ensure the robustness of my results, I also use alternative measurements in results section.

3.2.2. Independent variables

I use the index of marketization published by National Economic Research Institution (NERI) to measure differences in subnational institutions in different regions of China. This index includes an overall index measuring the institutional quality of each province of China. The overall index consists of five sub-indices. They are "government and market forces, development of non-SOEs, development of commodity markets, development of factor markets, and development of market intermediaries and a legal environment ([Shi et al., 2012, p.1233](#))".¹ Studies using this index have been published in several leading journals (e.g., [Chang and Wu, 2014](#); [Jia, 2014](#); [Shi et al., 2012](#)). The NERI index of marketization takes the value between 0 and 12, where 0 represents weak institutions and 12 represents strong institutions. To facilitate analysis, I subtract the regional institutional quality from 12, where 0 represents very strong subnational institutions (little corruption) and 12 represents very weak subnational institutions (severe corruption).

As the independent variable, NERI index, measures the overall quality of subnational institutions and the dependent variable, corruption, is only a partial reflection of the institutional environment in host countries. The logic link from independent to dependent variables might be weak in the sense that I am "comparing fruit to oranges".² I also use alternative indicators to make sure that the independent and dependent variable are matched at the same level. Detailed description follows in the results section.

Duration measures how long emerging market firms are immersed in the local institutions. Since firms in China seldom move their headquarters across provinces, duration is measured in firm age. The predicted sign of the interaction term between this variable and

¹ Although the first component of marketization index refers to "government and market forces", it has little connection to my second independent variable, government involvement. The sub-index, "government and market forces", quantifies the influence of the government in a market economy ([Fan et al., 2001](#)). Under the assumption that China needs to reduce its government size to build a market economy, [Fan et al. \(2001\)](#) measures the scale of regional governments (e.g., they calculated the regional fiscal revenues divided by regional GDP). It is a regional-level variable with the same value for all firms from that region. My second independent variable, government involvement, measures the influence of a local government in a specific firm; it is a firm-level variable varied across firms.

² Thanks to the anonymous reviewers for this nice analogy.

subnational institutions is positive.

Government involvement is another independent variable in my research. It is operationalized using a dichotomous measure. A firm is categorized as a SOE if its global ultimate controller is a national, provincial, or civic government, and as non-SOE otherwise. The ownership data come from Zephyr, Hong Kong Stock Exchange (HKSE), and CNInfo, an information disclosure website appointed by China Securities Regulatory Commission.

3.2.3. Control variables

I incorporate a series of controls to reduce the risk of omitted-variable bias. I use industry dummy variables (two-digit SIC codes) to control industry fixed-effects. Thirteen industry dummies are created. However, too many dummies in a logit model, which is the estimation technique I employ that I will later detail, will increase the chance of complete separation, in which the maximum likelihood estimate does not exist and model cannot converge. In this case, researchers make a choice to either drop the categorical variables that perfectly split the dependent variable or to merge these variables. I employ the first strategy in the main models and include all the industry dummies using alternative estimation methods in the robustness tests.

After observing the trend of China's FDI depicted in Fig. 2, I find that there is an increasing trend in outward FDI of Chinese multinationals. Hence, I include a time variable in models to control this trend. I also capture some firm level variables including size, profitability, and international experience. Size is measured in total assets, which is log-transformed to reduce skewness. Profitability is captured in firm's return on assets (ROA). International experience is an essential control variable in my research because overseas experience also helps firms operate effectively in corrupt destinations. I measure this variable by counting the number of outward FDI deals the focal firm and its relevant firms made in the past. The relevant firms are measured as the focal firm's parents, brothers (owned by a same ultimate controller), and subsidiaries. I collected data through various approaches, including Zephyr, HKSE, CNInfo, and China Stock Market and Accounting Research Database (CSMAR). Several SOEs that affiliated at the state and provincial level are non-listed, but I still found accounting information for part of SOEs from the press releases of China's State-owned Assets Supervision and Administration Commission (SASAC).

I also measure two transaction-based variables: entry mode and diversification. Numerous studies have testified the influence of corruption on entry mode (e.g., Uhlenbruck et al., 2006). I code the entry mode as 1 if the firm enters as a WOS, and 0 if it enters as a JV. This variable is included in the robustness checks but not in the main models since it causes perfect separation in Model 4 of the logit models. It is generally believed that unrelated diversification induces higher risks than related diversification (Montgomery and Singh, 1984). I include diversification as a control variable in the analysis to account for the confounding effect of related vs. unrelated diversification. I code diversification as zero when the investor and the target's 2-digit primary SIC codes are the same, and one otherwise.

3.3. Model specification

As the primary estimation method, I use a binary logit models with standard errors clustered by firms to restrain heteroscedasticity problem. I also fit the models with standard errors clustered by year, industry, and province. and the results are similar. The equations are as follows.

$$\ln\left(\frac{P_{it}}{1 - P_{it}}\right) = \beta_0 + \beta_1 SubIns_{it} + \beta_2 SOE_{it} + \mathbf{X}'\boldsymbol{\beta} + \varepsilon_{it}, \quad (1)$$

$$\ln\left(\frac{P_{it}}{1 - P_{it}}\right) = \beta_0 + (\beta_1 + \beta_3 Duration_{it}) SubIns_{it} + \beta_2 SOE_{it} + \beta_4 Duration_{it} + \mathbf{X}'\boldsymbol{\beta} + \varepsilon_{it}, \quad (2)$$

$$\ln\left(\frac{P_{it}}{1 - P_{it}}\right) = \beta_0 + (\beta_1 + \beta_3 Duration_{it} + \beta_5 SOE_{it} + \beta_7 Duration_{it} SOE_{it}) SubIns_{it} + \beta_2 SOE_{it} + \beta_4 Duration_{it} + \beta_6 Duration_{it} SOE_{it} + \mathbf{X}'\boldsymbol{\beta} + \varepsilon_{it}, \quad (3)$$

where i refers to the focal firm and t denotes the time when outward FDI happens. $SubIns_{it}$ denotes subnational institutions in the region where emerging market firms grow up, $Duration_{it}$ denotes how long emerging market firms are immersed in the local institutions, and SOE_{it} is a dummy indicating the ownership of focal firms. Hypotheses (1a) and (2a) predict that the coefficient of subnational institutions, β_1 , and the coefficient of SOE dummy, β_2 , will be positive in Eq. (1). Hypothesis (1b) predicts that duration strengthens the relationship between subnational institutions and location choice. Hence the coefficient of interaction term between subnational institutions and duration, β_3 , should be positive in Eq. (2). Hypothesis (2b) predicts that government involvement complicates the moderating relationship among institutions, duration, and location choice, creating a three-way interaction in Eq. (3). Because the logit model I employ in this paper is a non-linear model, the standard procedures developed by previous researchers (e.g., Dawson and Richter, 2006) to probe three-way interactions in linear models are inapplicable. However, the purpose of their article is to test whether the slope of dependent variable on independent variable is significantly different at conditional values of moderators, and this principle still applies to non-linear models. If whether a firm is a SOE moderates the relationships between subnational institutions and duration, the slope of subnational institutions (the terms in the parentheses of Eq. (3)) should vary significantly across different values of SOE. In this sense, we get the null hypothesis,

Table 1
Descriptive statistics.

Variable	1	2	3	4	5	6	7	8	9	10	11
1. In a relatively corrupt country (1) or not (0)	1										
2. Host country corruption	0.82***	1									
3. Year	-0.09	-0.09	1								
4. JV (0) versus WOS (1)	-0.44***	-0.43***	0.21*	1							
5. Total assets (log)	-0.03	0.03	0.18*	-0.03	1						
6. ROA	0.09	0.05	0.19*	-0.03	-0.16	1					
7. International experience	0.02	0.03	0.18*	0.04	0.37***	-0.00	1				
8. Related (0) versus unrelated (1) diversification	-0.22**	-0.28***	0.13	0.00	0.06	-0.07	0.05	1			
9. SOE (1) or non-SOE (0)	0.02	0.05	-0.20*	-0.05	0.21*	-0.15	0.08	0.14	1		
10. Regional corruption	0.13	0.10	-0.39***	-0.21*	-0.13	-0.12	-0.17*	-0.06	0.25**	1	
11. Duration	0.01	0.14	0.22**	-0.09	0.38***	0.04	0.14	0.01	0.07	-0.02	1
Mean	0.19	-1.04	2006.29	0.5	20.27	0.05	0.64	0.32	0.57	3.79	11.27
S.D.	0.39	1.03	2.26	0.5	1.74	0.07	1.3	0.47	0.5	1.86	9.09
Min	0	-2.3	2001	0	15.15	-0.21	0	0	0	0.2	1
Max	1	1.22	2009	1	25.59	0.34	7	1	1	8.33	59

Note: $N = 143$.

* $p < 0.05$.

** $p < 0.01$.

*** $p < 0.001$.

$$(\beta_1 + \beta_3 Duration_{it} + \beta_5 SOE_{it}^1 + \beta_7 Duration_{it} SOE_{it}^1) SubIns_{it} - (\beta_1 + \beta_3 Duration_{it} + \beta_5 SOE_{it}^0 + \beta_7 Duration_{it} SOE_{it}^0) SubIns_{it} = 0,$$

Simplify this equation will result in:

$$(\beta_5 SOE_{it}^1 + \beta_7 Duration_{it} SOE_{it}^1 - \beta_5 SOE_{it}^0 - \beta_7 Duration_{it} SOE_{it}^0) SubIns_{it} = 0.$$

Because the coefficients in logit model are normally distributed, the linear combination of coefficients above is also normally distributed. Rejecting the null hypothesis that government involvement does not interfere the moderating relationship between institutions and duration leads to the alternative hypothesis:

$$H2b: (\beta_5 SOE_{it}^1 + \beta_7 Duration_{it} SOE_{it}^1 - \beta_5 SOE_{it}^0 - \beta_7 Duration_{it} SOE_{it}^0) SubIns_{it} \neq 0 \quad (4)$$

4. Results

Table 1 reports descriptive statistics and correlations. Note that multicollinearity is not a severe problem in this research as no variables are highly correlated in the table.

Table 2 reports the results testing all four hypotheses. To avoid multicollinearity problems when interaction terms are introduced into models, all continuous independent variables are standardized in the regressions. Model 1 includes only control variables. Subnational institutions and the SOE dummy are introduced in Model 2. The coefficient for regional institutions has the predicted positive sign, but is only marginal significant ($p < 0.1$). This coefficient remains marginally significant in Model 3, when duration variable is added into the model. Moreover, the SOE variable are insignificant in Model 2 and 3, failing to provide evidence for H1b, and the moderating effect of duration is also insignificant in Model 3, failing to provide evidence for H1b. Only H1a receives marginal support in the previous 3 models, implying that the interactions among subnational institutions, duration, and government involvement are more complex than expected.

To simplify analysis, I split the sample by firm ownership in Model 4 and 5. The motivation behind this approach is to further test H1a and H1b and see whether institutional advantage as a mechanism to navigate emerging market firms' location choice is bounded by a firm's ownership structure. The results fit my expectations. In non-SOE subsample, subnational institutions are positively associated with propensity to enter relatively corrupt countries ($p < 0.05$). In addition, the effects become strengthened when firms are chronically exposed to the corrupt environment at home ($p < 0.1$). Model 4 hence provides support for H1a and partial support for H1b. In SOE subsample, the main effect disappears: subnational institutions have no significant effect on the location choices of SOEs, and firm age is irrelevant in the relationship between subnational institutions and location choice. These results show that H1a and H1b hold well for non-SOEs but do not fit the internationalization paths of SOEs. The results fail to provide evidence in support of H2a. This verifies my conjecture that SOEs do not rely on the institutional advantage of emerging market firms—effectively cooperating with bureaucratic systems, smartly retarding and withstanding illicit demands from officials, and efficiently bribing governors if necessary—to promote their internationalization efforts. Turning the home country government into their agents and being motivated by diverse government policies (Boddewyn and Brewer, 1994; Luo et al., 2010; Wang et al., 2012a), SOEs are less concerned about the institutional quality in host countries.

In Model 6, I interact government involvement with both subnational institutions and the interacting term of subnational institutions and duration, thus creating three two-way interactions and a three-way interaction. My rationale is that SOEs have less institutional advantage that is accumulated through chronically learning in weak institutions. If my conjecture is right, the three-way

Table 2

Logit model of location choices for firms from different regions an emerging market.

DV: In a relatively corrupt country (1) or not (0)		Full (1)	Full (2)	Full (3)	Non-SOE (4)	SOE (5)	Full (6)
Subnational institutions	H1a: $\beta_1 +$		0.491 [†] (0.273)	0.504 [†] (0.274)	1.423* (0.571)	0.231 (0.391)	1.154* (0.529)
(1) SOE versus (0) non-SOE	H2a: $\beta_2 +$		0.173 (0.545)	0.173 (0.545)			0.177 (0.549)
Duration (years)				-0.034 (0.320)	0.250 (0.886)	0.371 (0.333)	0.366 (0.715)
Subnational institutions × Duration	H1b: $\beta_3 +$			0.029 (0.295)	1.960 [†] (1.028)	-0.232 (0.282)	1.279 [†] (0.706)
Subnational institutions × SOE							-0.851 (0.596)
Duration × SOE							-0.360 (0.732)
Subnational institutions × Duration × SOE							-1.433* (0.709)
Total assets (log)		-0.040 (0.162)	-0.000 (0.190)	0.002 (0.203)	0.219 (0.233)	-0.258 (0.264)	0.050 (0.207)
International experience		0.118 (0.197)	0.119 (0.217)	0.124 (0.223)	1.371** (0.479)	-0.373 (0.291)	0.067 (0.221)
Related (0) versus unrelated (1) diversification		-1.590* (0.657)	-1.660* (0.654)	-1.656* (0.688)	-4.069** (1.570)	-2.310* (0.956)	-1.616* (0.661)
ROA		3.804 (2.918)	5.302 [†] (3.168)	5.322 [†] (3.150)	7.089 [†] (4.070)	3.917 (4.282)	5.729 [†] (2.950)
Year		-0.103 (0.111)	-0.037 (0.110)	-0.035 (0.107)	-0.232 (0.170)	0.063 (0.201)	-0.076 (0.114)
Constant		206.028 (222.777)	72.399 (221.836)	69.590 (214.886)	458.349 (341.938)	-122.319 (402.707)	149.697 (229.626)
Industry fixed-effects ^a		YES	YES	YES	YES	YES	YES
Slope difference test (z test)	H2b: $\neq 0$						-1.98* (0.118)
χ^2		14.100	17.747	18.670	24.338	16.911	25.045
AIC		144.140	144.159	148.147	61.557	82.464	151.102
N		143	143	143	61	82	143

[†] $p < 0.10$, * $p < 0.05$, ** $p < 0.01$. S.E. clustered by acquirer.

a. Model 1, 2, 3, and 6 include five industry dummies; Model 4 includes three industry dummies; Model 5 includes two industry dummies.

interaction should be significant in Model 6, and the null hypothesis that there are no slope differences between SOEs and non-SOEs should be rejected (see Eq. (4)). The results pertaining to the former indicates that the relation between subnational institutions and location choice varies across levels of moderators ($p < 0.05$), but it does not tell us whether the significant three-way interaction is the result of duration, government involvement, or combination of the two variables. The slope difference test, however, indicates that the slope of location choice on subnational institutions differs significantly between SOEs and non-SOEs ($z = -1.98$), providing direct support for H2b.

Fig. 3 visualizes the three-way interaction in Model 6. The left figure portrays non-SOEs' predicted probability of investing in a

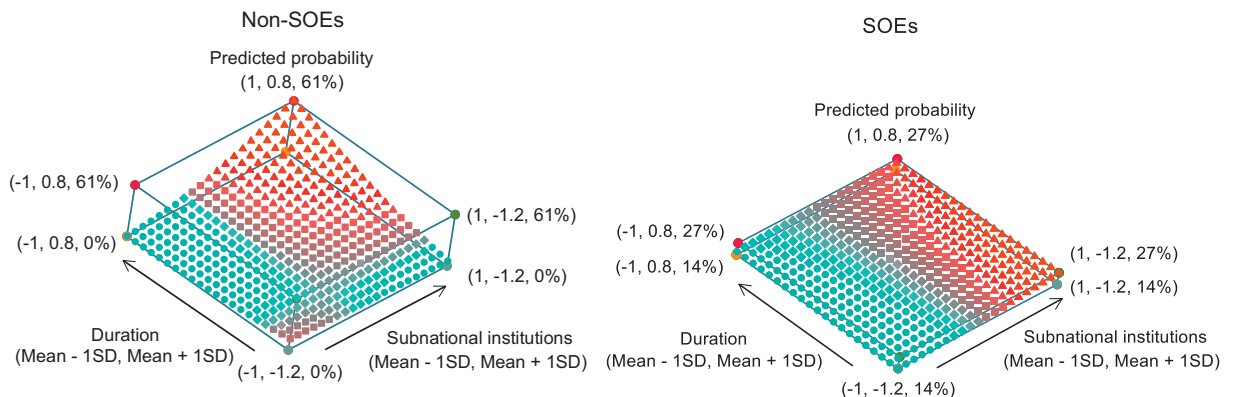


Fig. 3. Visualizing the interaction effects for non-SOEs and SOEs based on Model 6 of Table 2.

Note: The range of standardized subnational institutions (X axis) and standardized duration (Y axis) is (Mean – 1SD, Mean + 1SD). I use *margins* command in STATA to estimate the adjusted predicted probability of location choice = 1 and *graph3d* command to draw this figure.

Table 3
Robustness checks applying different standard error estimates and statistical models.

		Panel A: Logit model of location choice			Panel B: OLS model of location preference			Panel C: OLS model of location preference		
		Non-SOE	SOE	Full	Non-SOE	SOE	Full	Non-SOE	SOE	Full
Subnational institutions	H1a: β_1	1.423 [†]	0.231	1.154*	0.433*	-0.110	0.369*	0.505*	-0.151	0.340 [†]
	+	(0.840)	(0.320)	(0.482)	(0.201)	(0.133)	(0.157)	(0.239)	(0.138)	(0.181)
Duration		0.250	0.371	0.366	-0.086	0.128 [†]	0.153	-0.195	0.136 [†]	0.070
		(1.249)	(0.343)	(0.783)	(0.322)	(0.066)	(0.287)	(0.295)	(0.071)	(0.282)
Subnational institutions × Duration	H1b: β_3	1.960 [†]	-0.232	1.279 [†]	0.617*	0.034	0.627**	0.653*	-0.001	0.628**
	+	(1.142)	(0.357)	(0.751)	(0.241)	(0.099)	(0.214)	(0.252)	(0.125)	(0.232)
SOE (0/1)				0.177			0.187			0.319
				(0.385)			(0.197)			(0.242)
Subnational institutions × SOE				-0.851			-0.402*			-0.398 [†]
				(0.633)			(0.196)			(0.225)
Duration × SOE				-0.360			-0.086			0.018
				(0.777)			(0.287)			(0.280)
Subnational institutions × Duration × SOE				-1.433 [†]			-0.575*			-0.609*
				(0.848)			(0.238)			(0.260)
International experience ^a		YES	YES	YES	YES	YES	YES	YES	YES	YES
Industry fixed-effects ^b		YES	YES	YES	YES	YES	YES	YES	YES	YES
Year fixed-effects								YES	YES	YES
Other Controls		YES	YES	YES	YES	YES	YES	YES	YES	YES
Slope difference test (z value in 3 and t value in 6 and 9)	H2b: \neq 0			-1.99*			-2.53*			-2.34*
χ^2 (1-3) or Adjusted R ² (4-9)		532.925	54.694	161.374	0.349	0.325	0.262	0.331	0.326	0.254

Models in Panel A, B, and C apply standard errors clustered by province, acquirer, and acquirer, respectively.

[†] $p < 0.10$, * $p < 0.05$, ** $p < 0.01$.

a. Divided into direct experience and indirect experience in Panel C.

b. The first three models in Panel A include three, two, and five industry dummies, respectively; the remaining models in Panel B and C include all industry dummies.

relatively corrupt country, and the right one portrays the predicted probability of SOEs. X axis (in the right) is subnational institutions, Y axis (in the left) is duration, and Z axis (the vertical edge in the middle) is predicted probability. Overall, the probability of investing in a relatively corrupt country is higher for firms from regions with weaker subnational institutions and firms having chronic exposure to those institutions. Moreover, such trend is more remarkable for non-SOEs than SOEs. The predicted probability increases from 16% to 61% in the left figure, while it increases from 14% to 27% in the right one. The sharp change in the location probability of non-SOEs reveals that non-SOEs involves more in institution-embedded learning and accumulate higher level of institutional advantage as a result. This lends additional support for H2b.

4.1. Robustness checks

I also carry out extensive sensitivity analyses. The models in Table 3 apply different standard error structures and include various explanatory variables but yield consistent results. Below are detailed descriptions.

First, one should note that cluster-based inference requires a large cluster count and a large cluster size (Angrist and Pischke, 2008; Wooldridge, 2003). The models in Table 2 assume that cross-border M&As are independent across different companies but correlated for different deals by the same company. Therefore, > 100 clusters are created in these models, vastly reducing the size of each cluster. To mitigate such problems, I also apply province-clustered (24 clusters) and year-clustered estimates (9 clusters). The former approach assumes that cross-border M&As are nested for companies from a given province and the latter assumes cross-border M&As in the same year are correlated. Panel A of Table 3 presents the results of province-clustered estimates. The results conform to my expectation, though the level at which the result corresponding H2b is reduced: the weakening effect of SOE on accumulation of institutional advantage becomes only marginally significant ($p < 0.1$). The results of year-clustered estimates are similar but not shown here to save space. Econometricians suggest > 50 clusters would be reasonably safe for a clustered sample structure (Angrist and Pischke, 2008). Since my focus here is consistency of my parameters rather than within-cluster variability, I believe that the models assuming acquirer-clustered structure are more persuasive than models with province- or year-clustered structure.

Second, one should note that the logit model in this article is slightly different from the location choice models in previous studies. In previous research, researchers observe the entry-or-not decision of a firm and hypothesize its location preference based on the real choices it has made (e.g., Chung and Alcácer, 2002; Head et al., 1995). The inherent preference that drives the choice of firms, nonetheless, is unobservable. In this article, the location choice variable is created through dichotomization. Because the level of

corruption in a host country is known to firms (and researchers), we can infer a firm's latent preference using the corruption index in host country.

In other words, we will lose information on firm's underlying location preference when the median split method is used. The logit model would be less efficient than OLS model in this sense. To estimate whether subnational institutions affect emerging market firms' location preference, I use an OLS estimation using corruption index as the dependent variable. To measure this variable, I take a negative sign of the control of corruption index, where 2.5 means the most corrupt destination and -2.5 means the least corrupt. The corruption level in host country approximates the location preference of emerging market firms.

Another advantage of OLS estimation is that I need not to worry about perfect separation problem and am able to control more variables. Panel B and C of Table 3 present the OLS results. Entry mode (JV or WOS) is controlled in both panels. Panel C divides international experience variable into direct and indirect experience. Direct experience measures the experience coming from firm's own past operations, and indirect experience measures the experience transferred from the focal firm's parent firm, brother firm, and subsidiaries. I use this design to exclude the alternative explanation that it is the international experience of emerging market firms that triggers their special location choices. Lastly, Panel C also includes time fixed effects. As we can see, the parameters of independent variables are consistent with those in main models.

4.2. Alternative explanations

4.2.1. Neo-colonialism hypothesis

I propose capability-based hypotheses in this paper. Emerging market firms enter relatively corrupt host countries because they have special capabilities, which constitute their institutional advantage that is not possessed by multinationals from developed countries (Ahuja and Yayavaram, 2011; Martin, 2014). However, there are competing theories on the internationalization of emerging market firms in international business field. For example, the springboard perspective emphasizes the resource-seeking aspect of emerging market firms. From this perspective, emerging market multinationals tend to enter a host country where they can seek valuable resources that are not available elsewhere (Luo and Tung, 2007; Ramamurti, 2012; Yoo and Reimann, 2017). Reflected in media coverage, this is akin to the "neocolonialism hypothesis", which argues that emerging market firms enter less developed African and Latin American countries to exploit their natural resources or the profit potential (e.g., Grammaticas, 2012; Wagner and Cafiero, 2013; Poplak, 2016). If this is true, the relationship between subnational institutions and location choice of emerging market firms may not be driven by institutional advantage, but by resource-seeking motivations.

To exclude such an explanation, I use two additional dependent variables, which measure the natural resources and the market potential of host countries, to refit the model. The results are in Table 4. Panel A of Table 4 divides the host country into two types, the one that is rich in natural resources and the one with few natural resources. I use crude oil reserve as a proxy of natural resource in a host country. The information is collected from the U.S. Energy Information Administration. A host country receives a value of one if its crude oil reserve is larger than the median value of that year and receives a value of zero otherwise. Panel B of Table 4

Table 4
Testing neo colonialism hypothesis and relative competitiveness hypothesis.

	Panel A: Logit model of location choice. Neo colonialism hypothesis			Panel B: Logit model of location choice. Neo colonialism hypothesis			Panel C: Logit model of location choice. Relative competitiveness hypothesis		
	Non-SOE	SOE	Full	Non-SOE	SOE	Full	Non-SOE	SOE	Full
Dependent Variable	(1) The Host country is rich in natural resources (0) Otherwise			(1) The host country has great market potential (0) Otherwise			(1) The host country is weak in technological capabilities. (0) Otherwise.		
Subnational institutions	0.761 (0.652)	1.091* (0.484)	0.711 (0.503)	0.482 (0.540)	0.046 (0.347)	0.492 (0.446)	0.379 (0.585)	-0.084 (0.298)	0.535 (0.540)
Duration	-1.356 (0.884)	0.189 (0.247)	-0.949 (0.616)	-0.645 (0.936)	0.165 (0.272)	-0.597 (0.738)	1.885* (0.865)	0.994* (0.446)	1.023 (0.652)
Subnational institutions × Duration	-0.013 (0.815)	1.304* (0.649)	0.350 (0.755)	0.137 (0.651)	0.223 (0.363)	0.274 (0.685)	1.323 (0.863)	-0.491 (0.399)	1.272† (0.754)
SOE (1) versus non-SOE (0)			0.731 (0.519)			0.428 (0.499)			-0.111 (0.505)
Subnational institutions × SOE			0.074 (0.731)			-0.532 (0.573)			-0.577 (0.600)
Duration × SOE			1.170† (0.628)			0.810 (0.793)			-0.357 (0.783)
Subnational institutions × Duration × SOE			0.398 (0.939)			-0.221 (0.801)			-1.456† (0.875)
Other controls	YES	YES	YES	YES	YES	YES	YES	YES	YES
χ^2	17.097	21.723	49.781	20.050	4.106	19.003	19.739	15.508	28.295
N	61	77	138	59	79	138	58	77	135

Standard errors clustered by acquirer in SOE and full sample; robust standard errors in non-SOE sample. Parts of industry dummies are dropped to avoid perfect separation problem.

† $p < 0.10$, * $p < 0.05$, ** $p < 0.01$.

divides the host country by its market potential. I collect the information on population ages 0 to 14 for each country from World Bank. The larger the young population in a host country, the more likely it has substantial market potential. I split the countries in my sample into two types using the annual median value as a threshold. Note that the sample size shrinks a bit in these models because some countries do not have records on crude oil reserve or the youth of the population.

The coefficients in Panel A and B of Table 4 are significantly different from the coefficients in Model 4, 5, and 6 of Table 2, which allows me to dispel the neocolonialism hypothesis. Interestingly, the coefficients of subnational institutions and its interaction term is significant in the SOE sample of Panel A ($p < 0.05$), implying that SOEs might be more resource-seeking than non-SOEs. This finding is consistent with public opinion that some SOEs are pursuing political objectives designated by their respective home governments (Luo and Tung, 2007).

4.2.2. Relative competitiveness hypothesis

Furthermore, researchers also propose a relative competitiveness hypothesis of emerging market firms. They argue that the internationalization of emerging market firms follows the same path trotted by their developed-economy counterparts (Dunning et al., 2008). Emerging market firms invest in less developed (and often more corrupt) countries merely because they are relatively more competent than local companies (Ramamurti, 2012). In this sense, the traditional eclectic paradigm centered around the idea that multinationals must have ownership advantage before they engage in international business holds up well even for emerging market firms (Ramamurti, 2012).

To avoid spurious relationship that is purely driven by competitiveness of emerging market firms, I use a new variable, technological capabilities of a country, to test this hypothesis. I collect the information on number of patents that are recorded in “triadic patent families (TPF)” for each country. Triadic patent families (TPF) are defined as “a set of patents taken at the European Patent Office (EPO), the Japan Patent Office (JPO) and the US Patent and Trademark Office (USPTO) that protect the same invention (Dernis and Khan, 2004, p.17)”. Because patents included in the family are typically of higher value, they are thought to reflect the technological strength of a given country. Since the concern here is the relative competitiveness of a given country, I compare the number of TPF patents of a host country to that of China. If a host country has less high-value patents than China, it is likely that it is less competent than China in high-tech industries and more likely to become the targets of Chinese multinationals who would like to utilize their relative competitiveness overseas. For these host countries, they receive a value of one. Otherwise they will receive a value of zero. Panel C of Table 4 presents the results. Again, relative competitiveness hypothesis is not supported. The tests on neo colonialism argument and relative competitiveness hypothesis further support that institution-embedded learning is a mechanism independent of classic internationalization theories, and that emerging market firms have institutional advantage under certain circumstances (Mathews, 2006).

4.3. Analyzing the impacts of different types of subnational institutions

I have examined the relationship between subnational institutions and location choice of emerging market firms in multiple ways and excluded some alternative explanations so far. However, another concern is that I use a corruption index to operationalize the institutions in host country and a marketization index to operationalize the institutional quality in home regions. As they are not at the same level, it is akin to “comparing fruit to oranges”. In other words, the logic linking two constructs might be weak in light of the lack of comparability between the two measures.

To eliminate this concern, I use alternative indices from The Doing Business Survey to test the effects of different types of subnational institutions on the location choice of emerging market firms. In 2008, the World Bank surveyed 30 provincial capitals in China to compare the regulatory business environment across regions. This survey investigated qualities of three types of local institutions that support or restrain business activities: their ability to facilitate the initiation of businesses (*ex ante* institutions), their ability to ensure the successful implementation of businesses (*on-site* institutions), and their ability to settle disputes and ensure payments (*ex post* institutions). Since the World Bank also conducts similar research globally, it is possible to compare the survey results of China to those of other countries. Each type of local institutions is measured by two to three sub-indicators. I select four sub-indicators—starting a business, registering property, getting credit, and enforcing contract—to conduct the comparison because (a) they appear in both China and world surveys and (b) they have covered all three aspects of local institutions (*ex ante*, *on-site*, and *ex post*). Starting a business and registering property are *ex ante* institutions operationalized as the minimum calendar days to finish these activities. Getting credit, operationalized as the minimum time to complete all required procedures,³ is categorized under *on-site* institutions due to its self-explanatory importance in facilitating transactions. Enforcing contract, operationalized as the minimal days to settle disputes in the focal country, is categorized under *ex post* institutions. Four regressions are fitted. The independent variables are the minimal days to conduct the four activities in China, and the dependent variables (except for getting credit) are the numbers of days to do the same activities in host countries. Because the new dependent and independent variables are at the same level, this design is immune to the “comparing fruit to oranges” fallacy. I estimate them together using seemingly unrelated regressions (SUR) as they represent the same theoretical relationship and are systematically correlated in nature. One-tailed test is employed for independent variables since all hypotheses have been confirmed in sections above.

³ The global “Doing Business” survey does not provide the data on minimum days of getting credit in countries other than China; it uses a score measuring the easiness of getting credit in the host country instead. The score ranges from 0 to 100, where 100 means getting credit is extremely easy and 0 means getting credit is very difficult. I subtract the score from 100 to ensure that the sign of regression using this score is comparable to the signs of other regressions.

Table 5
Testing the effects of different types of subnational institutions using SUR.

	<i>Ex ante</i> business regulations			<i>Ex ante</i> business regulations			<i>Ex post</i> business regulations			<i>On-site</i> business regulations		
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)
Dependent variable:	Starting a business in host country (logged days)			Registering property in host country (logged days)			Enforcing contracts in host country (logged days)			Score of getting credit in host country (logged scores)		
Sub-indicator	Starting a business (logged days)			Registering property (logged days)			Enforcing contracts (logged days)			Getting credit (logged days)		
Duration	-0.02 (0.06)	-0.05 (0.06)	-0.34 [†] (0.23)	0.11 ^{**} (0.04)	0.10 [*] (0.05)	-0.04 (0.12)	0.04 (0.05)	0.04 (0.05)	-0.04 (0.06)	0.08 [†] (0.06)	0.07 (0.07)	0.00 (0.18)
Sub-indicator	-0.07 (0.07)	-0.08 (0.07)	-0.09 (0.09)	-0.07 (0.06)	-0.07 (0.06)	0.01 (0.10)	0.05 [*] (0.03)	0.05 [*] (0.03)	-0.001 (0.04)	0.12 [*] (0.07)	0.12 [*] (0.07)	0.15 [†] (0.11)
SOE (0/1)	0.21 [†] (0.14)	0.20 [†] (0.14)	0.22 [†] (0.15)	-0.20 (0.16)	-0.21 (0.16)	-0.20 (0.17)	0.17 ^{**} (0.06)	0.17 ^{**} (0.06)	0.13 ^{**} (0.05)	-0.05 (0.15)	-0.05 (0.15)	-0.09 (0.16)
Sub-indicator × Duration		0.06 [†] (0.04)	-0.12 (0.17)		0.02 (0.06)	-0.16 (0.14)		-0.01 (0.04)	0.02 (0.04)		0.01 (0.06)	0.07 (0.20)
Sub-indicator × SOE			0.00 (0.13)			-0.18 [†] (0.13)			0.16 ^{**} (0.06)			-0.03 (0.17)
Duration × SOE			0.37 [†] (0.25)			0.17 (0.14)			0.17 ^{**} (0.07)			0.20 (0.21)
Sub-indicator × Duration × SOE			0.12 (0.18)			0.20 [†] (0.15)			-0.20 ^{**} (0.07)			-0.16 (0.23)
Other controls	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES

[†] $p < 0.10$, * $p < 0.05$, ** $p < 0.01$. One-tailed test for independent variables. Standard errors clustered by acquirer.

Note: Table V presents three SUR estimations. Model 1, 4, 7, and 10 are fitted together; Model 2, 5, 8, and 11 are fitted together; and Model 3, 6, 9, 12 are fitted together. N = 198 for all estimations.

Before proceeding further, please note that the findings below are highly exploratory for four reasons: First, the China survey was conducted in 2008, almost at the end of my observation window (2001–2009). To ensure appropriate sample size, I employ a new dataset from Zephyr ranging from 2008, when the survey was released, through to 2014, when the latest FDI data are available. Second, because World Bank only conducted the country specific survey *once* in China, I have to assume that subnational institutions in China do *not* change between 2008 and 2014. Third, the one-tailed test increases the power of my result, while boosting the probability that I commit a Type I error. Lastly, the results may suffer from common method bias, as both dependent and independent variables were obtained via the same item with similar survey designs.

Table 5 reports the results. The institutional advantage argument obtains support, as can be seen in Columns 7 through 12, suggesting that firms chronically exposed to weak *ex post* and *on-site* regulations at home are more likely to enter host countries with equivalent weak *ex post* and *on-site* institutions. However, the institutional advantage argument receives little support in Columns 1 through 6, suggesting that weak *ex ante* regulations do not stimulate firms' accumulation of institutional advantage. In the meanwhile, SOEs are more likely than private firms to enter host countries where *ex post* regulations are incomplete (Column 7–9) and where starting new businesses requires substantial time (Column 1–3). Moreover, government involvement also hinders emerging market firms' institution-embedded learning within weak *ex post* regulations (Column 9), indicating that government involvement is a competing mechanism of institutional advantage argument and is an alternative for firms to overcome adverse conditions when internationalizing. In sum, only the test on *ex post* regulations, which measures the time and cost for resolving a commercial dispute and the quality of judicial systems (The World Bank Group, 2008), fully support all hypotheses. One possible answer is that my sample only consists of firms launching their international businesses via JV and M&A and does not include firms establishing WOS through greenfield investment (see Setting and sample section for detailed discussion). Since in both cases (JV and M&A), firms rely on partners to enter host countries, the quality of *ex post* regulations (enforcing contracts) that help alleviate transaction issues between partners become essential for emerging market firms to overcome the liability of foreignness and survive in an unfamiliar setting. Therefore, firms originating from regions where enforcing contracts is difficult will accumulate greater capability in co-operating with partners, and they are hence more likely to enter host countries in similar situations. This explanation coincides with previous findings that emerging market firms rely on network relationships rather than formal institutional support to enter host countries (Elango and Pattnaik, 2007).

In addition, as emerging market firms tend to buy into an on-going operation through JVs and M&As (Peng, 2012), the capabilities they acquired at home of starting a business, registering property, and getting credit (related to *ex ante* and *on-site* institutions) become less salient. If the sample was constituted by emerging market firms penetrating host countries via greenfield, the tests on *ex ante* and *on-site* institutions should yielded salient results. Again, this conclusion should be drawn with caution and empirically tested in future research.

5. Discussion

Drawing from insights from institutional advantage and organizational learning theory, I investigate whether distinctive features

of emerging markets, namely various subnational institutions, incubate distinctive institutional advantage of emerging market firms. Institutional advantage includes the skills of cooperating with inefficient bureaucratic systems, acquiring scarce resources, and navigating corruption, to name a few. Such advantage is observed in the internationalization of emerging market firms, during which firms originating and operating in regions with weak subnational institutions are more likely to enter host countries with weak institutional systems. Moreover, the duration of firms in unfavorable institutional environment strengthens the accumulation of institutional advantage, and private-owned emerging market firms are more motivated to pursue such institutional advantage.

Although the institutional advantage of emerging market firms suggests that they can navigate corruption effectively in home and host countries, it is unclear whether emerging market firms are utilizing anti-corruption or bribery capabilities throughout the journey. Optimistic readers may believe that emerging market firms adapt to the highly-corrupt environment through corruption-deterring capabilities, while pessimistic readers would argue that emerging market firms count on their superb bribery capabilities. Perhaps both anti-corruption and bribery capabilities are employed in the internationalization of emerging market firms. Future research may wish to study which capability dominates emerging market firms' internationalizations by testing the externality in host countries of investments by emerging market firms.

Naturally, this article has limitations. First, I do not have data on firms that choose to invest via greenfield. This could lead to a selection bias if the entry mode and location choices are nested (Shaver, 1998). Although it might not be a very big concern in China's case since M&A is the primary investment mode after 2000 (Li et al., 2012; Peng, 2012), the results would be more accurate if I get the data regarding the greenfield investment of Chinese multinationals, especially for the analysis on different types of subnational institutions. Second, I only consider the subnational institutions of a region in which the headquarter is located. This might lead to measurement errors when evaluating the institutional advantage of a multi-unit enterprises. Third, I draw conclusion from the empirical analysis of firms from a single economy, this could limit the external validity of my results.

Despite the shortcomings, I have collected data to the extent that was possible. The results shed light on a possible road for executives from emerging market firms who want to bring their businesses to the world. By sharpening their institutional advantage, multinationals from the developing countries can potentially find a path that is more compatible to their uniqueness than the extant routes forged by firms from the developed countries, and thus achieve greater success in the global competitive economy.

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