TITLE

Are EMMs any different? A comparison between the location choice of the developed and emerging market multinationals

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ABSTRACT

Due to the increased international activity of the emerging market multinationals (EMMs), they have become a subject of curiosity in the international business (IB) research. Their presence on the world economic stage has induced several debates about the applicability of the existing theoretical frameworks in order to explain the behavior of the EMMs when they are going abroad. The aim of this paper is to apply the alternative firm specific advantages theory of Cuervo-Cazurra and the complementary local assets theory of Hennart when analyzing the foreign direct investments (FDIs) and location choice of the EMMs. Moreover, the paper also provides a comparison between the decisions of developed and emerging market multinationals. Finally, the analysis of the location choice is not only focusing on the distance between the home and the host countries, but also takes into account the direction of the investment (i.e. towards a more or less developed country).

Keywords: location choice, firm-specific advantages, institutional distance, emerging markets, foreign direct investments

INTRODUCTION

Huawei, Lenovo, Haier…just a few examples of successful EMMs which became a subject of curiosity in the recent years. The EMMs raised the attention also among the IB scholars with their rapidly growing presence on the world economic stage. Moreover, these firms are being internationally active not only in terms of export but also through foreign direct investments (FDI). According to the UNCTAD, the 26.6% of the world FDI is coming from the emerging markets (2018) and in addition, these investments are targeting not only other emerging markets but also developed markets as well. The increased international activity of the EMMs has generated a significant interest for these firms in the field of international business both on the theoretical and on the empirical level.

This study has been motivated by the fact that EMMs have induced several theoretical questions related to their firm specific advantages, their internationalization strategies and their home country's influence on their strategic decisions. Numerous scholars have already investigated what kind of internationalization patterns do the EMMs follow (Lu et al. 2014) or if their strategic choices are affected by their home country's institutional background (Buckley et al. 2007). Moreover, it has been also widely discussed (Rugman, 2009; Cuervo-Cazurra, 2012; Narula, 2012; Ramamurti, 2012, Guillen & Garcia-Canal, 2009) whether the FDIs coming from the EMMs are requiring new theories or they can be explained by the existing theoretical frameworks. As the different theoretical approaches attribute different type of firm specific advantages (FSAs) to the EMMs, in this study we aim to contribute to the debate by arguing that through the location choice of the EMMs, it is possible to better understand their FSAs. More specifically, we believe that the direction of the FDIs of the EMMs will give further insights about the FSAs that they rely on when investing abroad.

First, we discuss the different theoretical aspects about the FSAs and FDI activities of the EMMs. We will illustrate the various theoretical viewpoints and these arguments will give a

basis for our empirical analysis of the location choice. The location choice of the EMMs is important because their FSAs should be complemented by country-specific advantages (CSAs) when they are taking a strategic decision as such. Consequently, we need to understand also the location choice decisions of the EMMs in order to advance theory on the FSAs.

Second, closely linked to the FDIs, one of the core decisions that a firm has to take is related to the location choice of the investment. Even though location choice is generally perceived as a research field that is reaching the level of maturity (Nielsen et al. 2017), it was pointed out that the topic has been investigated mainly from the point of view of the DMNEs (Li et al. 2018). Thus, we believe that we can contribute with further insights to this area of research by analyzing the location choice of the EMMs that represent a particular group of firms.

Third, differently from the previous studies, we do not focus on the exact destination of the investments, but on the direction of the FDIs. We suggest that there is a gap in research regarding the implications of the institutional distance and its direction. As it is emphasized by Shenkar (2001), the analysis of distance should incorporate the perspective of asymmetry, i.e. rather than the magnitude of distance in absolute terms, it should focus on the two directions of distance. In this view, the distance is considered as negative when firms enter a less developed country, while it is considered as positive when firms invest in more developed countries. This type of approach has been only recently recognized in relation with the institutional distance and firm performance (Chikhouni et al. 2017; Hernandez & Nieto, 2015; Trapczynski & Banalieva, 2016). In this study we seek to fill the research gap by implementing the asymmetric approach of institutional distance in the location choice research. Moreover, we aim to find out how is institutional distance in the location choice affected by the firm specific advantages of the EMMs?

The remainder of this paper is organized as follows. First, we illustrate the various theoretical viewpoints about the FDI activity of the EMMs and we formulate our hypothesis on the location choice of the EMMs. Next, we describe our data and present the results of the analysis. Finally, we discuss our findings and as a conclusion we highlight our contributions, point out our limitations and suggest possible future research developments.

THEORETICAL FRAMEWORK & HYPOTHESIS DEVELOPMENT

Background

There is an extensive literature about the internationalization of the multinational enterprises in the IB field. The main theories about the MNEs were developed in the 1970s based on the evidence from the experienced and mature Western MNEs and these paradigms are reflecting the characteristics of these firms MNEs (Meyer & Thaijongrak, 2013). The EMMs were a popular research topic in the late 1970s until the early 1990s (e.g. Lecraw, 1977,1993; Lall, 1983; Kumar & McLeod, 1981; Khan, 1986) when these firms started to appear on the global economic stage. Recently, the trend of internationalization of these firms brought them back to the spotlight of IB research (Khanna & Palepu, 2010). The main reason for this renewed interest is that in comparison with their developed market counterparts, EMMs are originating from different societies and economies, thus they are likely to have different motives and development paths for their FDI (Gaur & Kumar, 2010; Luo & Tung, 2007; Mathews, 2006). For this reason, the applicability of the existing theories to the FDI activity of the EMMs has been questioned by several scholars and provided room for research.

Theoretical framework

Dunning's OLI paradigm is commonly taken as a reference point for discussing whether the FDI activities by EMM can be explained by existing theories (Hennart, 2018; Lessard & Lucea,

2009). The OLI paradigm puts forward three necessary and sufficient conditions for a foreign direct investment to happen: the investing firm needs to possess an ownership advantage (1), a location advantage (2) and an internalization advantage (3).

However, two of these assumptions makes it difficult to apply the OLI paradigm to the EMMs' investments. First, it posits that the investing firms must be in the possession of ownership advantages, while EMMs are rarely possessing ownership advantages in its traditional sense such as advanced technology or strong brands names (Dunning & Lundan, 2008). Indeed, their investments abroad are often motivated by the search for FSAs rather than exploiting them. Second, the OLI paradigm assumes that the local resources at the foreign locations are freely (or at least at the same terms) available for all the firms – both for foreign and domestic firms alike. Still, it is not always the case, for example, government support and subsidies in the emerging markets (Hennart, 2012) that are available only to some privileged local firms.

The disconnect between the assumptions of Dunning's OLI paradigm and the empirical evidence of the existence of EMMs and their foreign direct investments provoked various reactions and theoretical explanations by the IB scholars. In the following section we will discuss the three main standpoints regarding this issue, highlighting the importance of the FSAs when investing abroad. Moreover, as the location choice is also a central argument of our study, we will combine the various theories of the FSAs and the location choice in order to advance theory on the internationalization of the EMMs. Consequently, our hypotheses will be built on these two pillars.

EMMs without FSAs

The first theoretical position in the debate on the applicability of the OLI paradigm to the FDI activity of the EMMs is the viewpoint of the internalization theory. The main proposition of Rugman's internalization theory (1981,1996) is that the firms go abroad in order to expand their

own FSAs. Similarly to Dunning's OLI paradigm, Rugman and Verbeke (1992) are also arguing for the necessity of the ownership advantages – or FSAs, as they call it – in the internationalization process of a firm. These FSAs can be technology or knowledge based or they can reflect managerial and/or marketing skills that are proprietary to the firm (Rugman & Verbeke, 2003). The other important building block of the theory of Rugman and Verbeke are the country-specific advantages (CSAs), which are based on the characteristics of the home country that are unique to each firm in the country. For example, a CSA can be the country's natural resource endowment or its labor force.

From the aspect of the EMMs, Rugman and Li (2007) argue that EMMs will be able to make sustainable investments only when they accumulate real FSAs such as cutting-edge technologies and strong brands. However, according to Rugman (2009), the EMMs do not have real FSAs and, especially in the case of knowledge-based FSAs, they are in disadvantage compared to the DMNEs. Consequently, in their FDI activity, the EMMs rely on the CSAs of their home county, such as cheap labor or natural resources, that are freely available for all firms. For this reason, Rugman and Li (2007) consider EMMs' international expansion as a short-lived phenomenon with short-term perspectives and claim that there is no reason to adapt the existing theory to the EMMs.

<u>Alternative theoretical explanations</u>

The second theoretical position is calling for an alternative interpretation of the OLI paradigm. Cuervo-Cazurra and Genc (2008) argue that both DMNEs and EMMs have ownership advantages, with the difference that the DMNEs tend to have stronger ones. Regarding the influence of the institutions of the home country on the firms' advantages, they argue that the disadvantage of the poor institutional environment in the developing countries can be turned into an advantage for the EMMs. The advantage derives from the fact that the EMMs are more used to working in an unstable institutional environment, where they face for example less

efficient market mechanisms, burdensome bureaucracy and/or inefficient judiciary systems, while the advanced market MNEs are not used to such conditions. Consequently, even if both developed market MNEs (DMNEs) and EMMs are facing difficulties during their internationalization process, the EMMs thanks to their ability to operate and manage in difficult institutional environment, will have an advantage over the DMNEs when expanding into other developing countries. So far, this hypothesis has been empirically tested by analyzing the prevalence of EMMs in the least-developed countries relatively to the DMNEs. Nevertheless, there is some anecdotal evidence to support this argument. According to Goldstein's report for the OECD (2004), Celtel (a British subsidiary of Vodafone) used to have a monopoly on Uganda's mobile phone market. However, when the South African MTN entered the market, it managed to build a 22 times larger subscriber base owing to its expertise in handling the economically and politically risky environment.

Relying on these types of advantages, when developing country MNEs are operating in third countries with difficult institutional conditions, they may face fewer difficulties than developed country MNEs (Cuervo-Cazurra & Genc, 2008). However, if we think about EMMs such as Huawei, Lenovo, Haier etc., it becomes clear that they are not limiting their investments to other emerging/developing countries with weak formal institutions. In order to test the theoretical explanation of Cuervo-Cazurra & Genc, and to find out whether EMMs invest in institutionally similar countries, we develop our first hypothesis as follows:

H1: The EMMs will invest in institutionally similar countries

In the third theoretical position, there is a different approach to the OLI paradigm and the FSAs of the EMMs. Hennart (2018) argues that the transaction cost view of the MNE, unlike the OLI paradigm, can accommodate both the FSA-seeking and the FSA-exploiting investments of the EMMs. It is possible because in the center of the TC theory there is the interdependence between the actors (in this case the firms) and not the actors themselves.

According to the TC theory, the foreign direct investments occur when it is more efficient to coordinate international interdependencies within a firm than through market arrangements as "land, natural resources, labor and distribution assets are sold in imperfect markets" (Hennart, 2012, p.169). The firms in order to avoid the high transaction costs of the market, they rather coordinate the transfer within their boundaries through acquisitions, joint ventures and greenfield investments.

Moreover, another important issue raised by Hennart (2009, 2012) is that, once again unlike the OLI paradigm, the location advantages may not be available for all the firms on the same terms. The condition of having a preferential access to these complementary local assets, often guaranteed by the home country governments, may "provide FSAs that are similar to the intangible-based FSAs which are central to the OLI paradigm" (Hennart, 2018, p. 569). This implies that the preferential access to the complementary local resources may raise the market power of the local firms, explaining the reason why EMMs can compete with DMNEs in generating profits and gaining market dominance in their home country.

Furthermore, the intangible asset-seeking FDI by the EMMs is possible because they find the time and the resources through their protected domestic market share and through their control of complementary local resources to gain dominance on their home market (Hennart, 2018). These characteristics are not only making them attractive partners for joint ventures, but it also allows them to make greenfield investments, acquisitions and to set up foreign country based joint ventures.

Similarly, Gaur et al. (2014) also argues that the EMMs are relying on their FSAs in a different way compared to the DMNEs. The reason for this is that because of the lack of traditional resources/FSAs, they exploit different type of resources such as an ethnic consumer base in the host country or the dominant position in their home market.

Finally, by the asset-seeking investment the EMMs go abroad in order to look for a specific knowledge that is required to leverage on the complementary local assets that they control. For example, the EMMs may undertake R&D investments in order to reach the technological parity with their developed market counterparts so as to be able to compete with them on the global market (Hennart et al. 2017). Hence, we suppose that the firms that gained dominance on their domestic market will leverage on this in order to invest abroad in institutionally more developed countries, where they can find the necessary assets to enhance further their competitiveness.

H2: EMMs that are dominant on their home market will invest in institutionally more developed countries

On the other hand, in the TC theory position, it is not ruled out that EMMs might have genuine FSAs and that they can exploit these FSAs when investing abroad. These FSAs are proprietary to the firm and by definition it is difficult to transfer them on the market. However, following the TC theory position, they can be exploited by FDI and joint ventures also by the EMMs. Furthermore, the genuine FSAs should also allow to the firms to exploit their FSAs in institutionally more developed markets and not only in institutionally similar or less developed environments. Moreover, some EMMs have also innovations that can find a market in both developed and emerging markets (Williamson, 2015). On the other hand, Demirbag et al. 2014 argue that the EMMs (in their case Turkish MNEs) will attempt to exploit their FSAs when they invest into other emerging markets in order to enhance their competitive advantage.

Given these arguments, our third hypothesis is that if they are doing an asset-exploiting investment where they rely on their knowledge-based FSAs, they will invest in institutionally less developed countries.

H3: EMMs that possess knowledge-based FSAs will invest in institutionally less developed countries

METHODOLOGY

Data sources and Sample

In order to test the significance of the FSAs in the location choice of the EMMs, we decided to focus on the location choice of the greenfield investments of the EMMs as these investments require an important commitment from the firms. Moreover, contrary to the M&As deals, where the choice of the location is driven by the location of the desired assets; in the case of greenfield investment the location choice is an important element of the strategic decision of the firms.

For the purpose of our analysis, we created a dataset containing greenfield foreign direct investments by individual firms both from developed and emerging market multinationals. The source was the fDi Markets of Financial Times, which database contains information about international greenfield FDI projects, and it has been widely used to study location choice (Duanmu, 2014; Anderson & Sutherland, 2015). Based on the data provided by fDi Markets, 20,000 investments have been manually checked between the period of 2006-2015. The manual check was necessary in order to avoid any overestimation, as the fDi Markets database is reporting announced FDI projects based on the statements of the firms. Even if the announcements are more trustful than the rumors used by other databases (e.g. Zephyr), we wanted to make sure that in our dataset there will be only successfully completed investments. For this reason, each investment has been checked for confirmation by online sources. This procedure enabled us to develop a dataset of 12,638 greenfield FDI investments (63%). In addition, we merged this dataset with the financial information available in the Orbis database about the investing firms. We excluded from our final sample the investments completed before 2009 and we focused only on the period after the global financial crisis. After the merge, the final sample is composed of 3,224 observations. In this subset, there are 61 home countries and 140 host countries and firms from 39 industries. Moreover, there are 2,795 investments

(86.69%) by DMNEs and 429 investments (13.31%) by EMMs. In the case of H1, we used the whole sample of 3,224 investments, including firms both from developed and emerging markets. However, H2 and H3 required a sample that only includes EMMs, and so in this case we used a restricted sample of 378 observations.

<u>Variables and Measures</u>

Dependent Variables

In line with the aim of this study, our dependent variable is the institutional distance between the home and the host countries. The institutional distance is a concept that captures the differences in the institutional environment between two countries (Kostova & Zaheer, 1999). In other words, the institutional distance represents the extent of similarity and dissimilarity between the institutional environment of two countries (Xu & Shenkar, 2002). Moreover, the institutional environment and the institutional distance have a great impact on the firms' strategy and performance (Peng et al. 2008, Gaur et al., Konara & Shirodkar 2018). The cost and the benefits of operating a business/doing a FDI related to the institutional distance vary not only because of the magnitude of the distance, but mostly because of the direction of the distance.

We measure institutional distance by the difference of the scores of the host and the home country based on the World Governance Indicators (WGI). The WGIs are used to evaluate the institutional setting of a country from six perspectives (Appendix 1): political stability and absence of violence, voice and accountability, governance effectiveness, regulatory quality, rule of law and the control of corruption (Kaufmann et al. 2009). The different variations of the WGIs are used in previous studies (Dikova & Van Witteloostuijn, 2007; Globerman & Shapiro, 2003) both as individual indicators (Lu et al. 2014; Lv & Spigarelli, 2016) and as a composite index (Slangen & Beugelsdijk 2010; Konara & Shrihodkar, 2018).

Accordingly, we run our model six times using each perspective as a dependent variable. It is important to highlight that this methodology allows us to account for the institutional distance between the countries, since there are multiple home and multiple host countries in the sample. This way, we avoid the issue highlighted by van Hoorn & Maseland (2016), who states that in case of a single home or host country, the models are simply measuring the distance from one institutional profile to many others, but not the institutional distance.

The first hypothesis is that EMMs invest in institutionally similar host countries. In order to test this hypothesis (H1), we create a variable based on the in the institutional distance between the home and the host countries of the investment in order to measure the institutional similarity. Given the home country's score on the WGIs, the variable *Similarity* takes the value 1 if the WGI score of the host country is smaller than the sum of the home country's score and its standard deviation (std) and if it is larger than the home country's WGI score minus its standard deviation (std), and 0 otherwise:

$$Similarity= 1 \text{ if } wgihost<=wgihome+std \text{ \& } wgihost>=wghome-std$$

Moreover, the variable *Similarity* is calculated for each WGI and it is also calculated for all the years, since the STD is changing year by year. In terms of signs, we expect a positive outcome that would confirm that EMMs select institutionally similar host countries as a location for their investments.

Furthermore, in the case of the second (H2) and the third (H3), we use the institutional distance as the dependent variable. Here the institutional distance is calculated as a result of the home country WGI score deducted from the host country WGI score. Similarly, also in these cases we run each regression six times accordingly to the different dimensions of institutional distance described by the WGIs. As an outcome, we expect a positive sign that would mean

that the EMMs select institutionally distant countries for their FDI investments when they are dominant on their home market or when they possess knowledge-based FSAs.

Independent Variable

In the case of H1, our main independent variable is a dummy variable taking the value 1 when the company originates from an emerging market. The variable refers to the theoretical claim according to which the EMMs are used to operate and manage unstable environments and so they tend to invest in other emerging markets.

Another methodological issue is to define which countries do we consider emerging markets. After comparing various classifications (e.g. IMF, FTSE, Goldman Sachs, MSCI, UNCTAD), we decided to use the classification of the emerging markets by the IMF, similarly to Banalieva et al. (2018), Quer et al. (2018) and Yang et al. (2013).

The second independent variable for H2 is the domestic market dominance of the firm that refers to the firm's position on its home market in its own sector. Since there are no prior studies that investigates this variable based on secondary data, we introduced a new variable based on the theory of the local complementary assets in order to capture the dominance of a firm on its domestic market in its own sector. This new variable is the domestic market dominance of the firm, which is measured by the fraction of the domestic revenues (total revenues-export revenues) of the firm and the average domestic revenue in the same sector in the home country. As a second step, this ratio is transformed by taking its natural logarithm. When the result is greater than 1, we consider the firm in possession of dominance in its domestic market.

Log Dominance= Ln (Domestic Revenue / Average domestic revenue in the same sector)

Finally, our third hypothesis (H3) is that EMMs that possess knowledge-based FSAs will invest in institutionally more developed countries. Accordingly, the third independent variable is the

knowledge-based FSAs of the firm, which is operationalized by the logarithm of the intangible fixed assets of the investing companies. In this case we want to measure the stock of knowledge accumulated and possessed by the investing firm, as it represents a type of firm-specific advantage.

Log Knowledge-based FSAs= Log (Intangible fixed assets, thousand USD)

Control Variables

In line with the previous studies of location choice, we consider certain country and firm level variables to control for important effects on the location choice decision (Appendix 2). First, we include several country level variables that represent the attractiveness of the host country as a destination of the FDIs. Similarly to the practice of previous studies, also in our analysis the host country's GDP/capita approximates its economic development (Buckley et al. 2007; Meyer et al. 2009; Lv & Spigarelli, 2016), the population of the host country is included as a measure of the host market's size (Yoo & Reimann, 2017; Lu et al. 2014), while the expenditure on R&D as a share of GDP indicates the technological development of the host country (Buckley & Casson, 2009; Dikova et al. 2019). Second, we include the trade openness of the host country that is measured as the share of trade by GDP that is reflecting the host country's openness in general towards international business activities (Beule & Duanmu, 2012). In addition, we control for the geographic distance between the home and the host countries as previous research suggests (Hernandez & Nieto, 2015) by calculating the distance between the most important cities/agglomerations of the home and the host country. Third, we included a dummy variable for signaling whether the home and the host countries are having common borders as the probability of FDI is higher if a common border is present (Rasciute & Downward, 2017) and also if the two countries share a common official language (Contractor et al. 2016). To control for the cultural distance, we encountered with the difficulty that a large share of the host countries in our sample are not included in the most widely used indicator, in

the database of Hofstede. As an alternative, similarly to Cuervo-Cazurra & Genc (2008), we decided to insert a dummy variable if the home and the host countries have colonial ties that represents the common history and, in some cases, a common cultural heritage. Finally, we decided to leave out the variables related to the home country characteristics as they were highly correlated with the independent variable of being on EMM or not.

Additionally, guided by previous studies, we control for several firm level variables. First, as the firm's size has a potential to increase its propensity to internationalize (Zahra, 2000), we approximate it by the natural logarithm of the number of employees of the firm (Chao & Kumar, 2010). Second, we include five different industrial sectors using Pavitt's (1984) well-known taxonomy and adding a fifth category for the services sector. The distribution of the firms within the sectors is relatively balanced as 23.01% of the firms in our sample belong to the ''Traditional'' sector, 16% to the ''Scale-intensive'' industries, 10.83% to the ''Specialized-suppliers'', 21.25% to the ''Science-based'' industries and finally 28.91% to the "Services". Furthermore, highly profitable firms are more likely to invest abroad, so we account for the firm's profitability by the fraction of its operating revenue and total sales (Wang et al. 2012), while its financial leverage ability we considered its debt to equity ratio (Chao & Kumar, 2010). Finally, for the second and the third hypothesis, where we use only the restricted sample of the EMMs, we included a dummy variable 1 if the investing company has been mentioned by the Boston Consulting Group (BCG) as a "Global challenger". The BCG defined Global challengers as exceptionally successful emerging market companies (2016). By confronting the list of the Global Challengers (editions from 2009 to 2015) with the firms in our sample, we find that a significant share of firms (27.04%) match to this criterion.

Model Estimation

The table in Appendix 3. summarizes the descriptive statistics and the correlation matrix of the variables. Moreover, as a further test for multicollinearity, we calculated the Variance Inflation Factors (VIFs) for all the variables. As a result, we found no individual VIF values greater than 10. Moreover, the average VIF value is 1.57 and 1.69 respectively for the second and the third hypothesis, which is well below the suggested threshold of 6. Given that these values are within the acceptable limits defined by the literature (Neter et al. 1989), we can absolutely exclude any problems of multicollinearity as a cause of concern in our analysis.

Our first hypothesis (H1) is that the EMMs invest into institutionally similar countries. To test our first hypothesis, we used a multiple logistic regression, where the dependent variable is the *Similarity* in all the six aspects of institutional dimensions represented by the WGIs. Similarity takes the value 1 whenever the score of the host country on the single institutional dimension is within the range of the home country's score (+/- its standard deviation). The basic formula for testing H1 is the following:

$$Similairity\ (WGI) = \beta 0 + \beta 1\ (EMM0/1) + \beta 2\ (Home\ Country) + \beta 3\ (Host\ Country) + \beta 4$$
$$(Firm) + \varepsilon$$

Regarding the second (H2) and the third (H3) hypothesis that refers to the relationship of the FSAs of the EMMs and the institutional distance between the home and the host country of the investment, we run an OLS regression in order to find out the effect of dominance and knowledge-based firm specific advantages on the direction of the institutional distance. In the case of these regressions, a negative sign indicates an investment towards a less institutionally developed country, while a positive sign indicates an investment to an institutionally more developed country. Moreover, also in this case the institutional distance is calculated on all the

six dimensions of the WGI and relatively to the year of the investment. The baseline hypothesis for all the regressions of the second (H2) and third (H3) hypothesis:

Host-Home institutional distance = β0 + β1 (Home Country) + β2 (Host Country) + β3 (Firm) + ε

Finally, it should be noted that the dependent variables as well as the continuous independent and control variables are all included in the model with a one-year lag in order to account for the time difference between the given state of world (country- and firm level variables) and the future investment location decision (realization of the investment).

RESULTS

First, Table 1 reports the outcomes of the six multiple logistic regressions based on the institutional similarity in terms of political stability and absence of violence (PS), voice and accountability (VA), government effectiveness (GE), regulatory quality (RQ), rule of law (RL) and control of corruption (CC).

Table 1.

Given the results of the hypothesis test, we found support for EMMs invest in institutionally similar countries. The first hypothesis is supported when the institutional similarity is defined in terms of government effectiveness (GE), the rule of law (RL) and the control of corruption (CC). The support is evidenced by a positive (2.21) and significant ($p<0.05$) z-value for the dimension of government effectiveness, as well as in the case of rule of law (2.09, $p<0.05$) and the control of corruption (4.52, $p<0.01$). Moreover, the test resulted in negative and significant results for two other aspects of institutional similarity: both for the dimension political stability

and absence of violence (-3.62, *p*<0.01), and for the voice and accountability dimension (-5.40, *p*<0.01). This implies that EMMs invest not only in institutionally similar, but also in institutionally dissimilar (both more and less developed) countries. In addition, regarding the control variables, the z-value for the firm size turned out to be negative and highly significant (*p*<0.01) for 5 out of 6 aspects of institutional distance. This suggests that the larger is the firm size, the less likely that it invests in an institutionally similar country. Furthermore, the common border, language and colonial ties between the home and the host country turned out to be positive and significant variables. This result confirms that these variables are important factors in the location choice of the firms. Finally, the first hypothesis was not supported when the institutional similarity is expressed in terms of regulatory quality.

Second, Table 2 reports the outcomes of the six multiple regressions based on the dominance of the firm and the six perspectives of institutional distance.

Table 2.

The second hypothesis test also delivered significant results. As evidenced by the coefficients, the institutional distance is negatively and significantly related to the dominance of the firms, except for voice and accountability (VA) and the rule of law (RL). This suggests that, opposingly to our expectations, the more dominant the firm is in its sector and on its domestic market, the institutional distance between its home and the selected host county will be negative, i.e. it will invest in an institutionally less develop host country. In contrast, the control variables related to the firms' profitability and its leverage are positive and significant in 4 out of 6 cases. This implies that the more profitable the firm is, the institutional distance between the home and the host country of the investment is positive, i.e. the investment takes place in an institutionally more developed country. Similarly, the more financial leverage ability the firm has, the direction of the institutional distance between the home and the host country of

the investment is positive. Finally, negative and significant sign of the common language between the home and the host country suggests that the larger the institutional distance is, the more likely that the two countries do not have a common official language. However, as the institutional distance increases between the host and the home country of the investment, the more likely that they had colonial ties in the past, as it is suggested by the positive and significant outcome. It may happen is the case when an EMM invest to its former colonial country.

Third, Table 3 shows the outcomes of the six multiple regressions based on the third hypothesis that refers to the relationship of knowledge-based FSAs of the firm and the six dimensions of institutional distance.

Table 3.

The third hypothesis states that the EMMs with knowledge related FSAs will invest in institutionally more developed countries. This hypothesis is supported as the test led to negative and significant results in 4 out of 6 cases, except for the voice and accountability (VA) and regulatory quality (RQ) aspects of institutional distance. The negative coefficients suggest that the relationship between the firms' knowledge-based FSAs and the institutional distance of the home and the host country of the investment is negative. This implies that the direction of the investment is negative, i.e. the EMMs with higher level of knowledge-based FSAs will invest in institutionally less developed countries. Finally, as it regards the control variables, the firm's size and its leverage have a positive and significant relationship with the institutional distance of the host and home country. This suggests that the larger is the firm and the more financial leverage it has, the direction of the investment is positive and the more likely it is that it will invest in institutionally more developed countries. Similarly to the results of the previous hypothesis (H2), also in this case the common official language between the host and the home

country is negative and significant in 4 out of 6 cases, while the variable representing the colonial ties is positive and significant in 4 out of 6 cases.

DISCUSSION AND CONCLUSION

<u>Findings and theoretical contributions</u>

The ideas discussed in the article aim to contribute to the ongoing debate on the applicability of the existing theories to the FDIs of the EMMs. We intend to advance the theory by confronting and testing the various theoretical approaches.

Building on the theory that states that the EMMs tend to invest into institutionally similar countries (Cuervo-Cazurra & Genc, 2008), we show that it holds only for certain types of institutional distance. By specifying the types of institutional distance based on the Worldwide Governance Indicators and establishing a measure for similarity, our results show that the EMMs invest in institutionally similar when it comes to the government effectiveness (GE), the rule of law (RL) and the control of corruption (CC). However, we also found that in terms of political stability (PS) and voice and accountability (VA), the EMMs tend to invest in institutionally dissimilar countries.

These findings are in line with several previous studies that analyzed the relationship between the location choice and the single aspects of the institutional distance. First, in terms of political stability, there is empirical evidence both for the preference for politically stable (Demirbag et al. 2010; Lv & Spigarelli, 2016; Dikova et al. 2019) and unstable (Deng & Yang, 2010; Witte et al. 2017) host countries. Moreover, Buckley et al. (2007) find that political stability is not even significant in the location choice of the EMMs. Our results show that EMMs invest into institutionally dissimilar countries in terms of political stability and absence of violence. Regarding the direction of these types of investment, we found that those EMMs that invest

into institutionally dissimilar countries, are choosing host countries with higher level of political stability as a location for their greenfield investments, i.e. institutionally more developed countries. A possible explanation for this choice is that even if EMMs are used to manage and operate in institutionally unstable environments, where the regulations are not so effective or the corruption is present, but they are more deterred by the political instability of a country on which they cannot have any control. Moreover, regarding the voice and accountability (VA) that represents the freedom of citizens, previous studies claim that this aspect tends to be less relevant for the foreign investors when making their location choice (Duanmu, 2012; Cuervo-Cazurra & Genc, 2008). In this case, we found that similarly to the political stability, EMMs tend to invest in institutionally dissimilar but more developed countries.

Second, the regulatory quality of the host country is generally stated to be an important factor for the location choice of the firms, as it is associated with transparency and fair regulations. However, in the case the EMMs which are more familiar with lower regulatory quality environments, the effect of regulatory quality is not so straightforward (Cui et al. 2016). It is confirmed also by our results, according to which the institutional distance in terms of regulatory quality is not significant in the location choice of the EMMs.

Third, from the point of view of government effectiveness (GE), rule of law (RL) and control of corruption (CC), our results confirm the theory according to which EMMs prefer to invest in institutionally similar countries. Government effectiveness is viewed as an essential prerequisite for the foreign investors; however, it is found to be a negative factor for the EMMs (Deng & Yang, 2015). Our results are in line with these findings, specifying that EMMs tend to select as a location the countries where the government effectiveness is similar to their home country.

Moreover, we also found that EMMs prefer to invest in host countries with a similar level of rule of law. Previous studies analyzing M&As have already confirmed that EMMs are more

attracted to host countries with poor rule of law (De Beule & Duanmu, 2012; Lv & Spigarelli, 2016). Selecting a host country with similar institutional characteristics in terms of rule of law as a location by the EMMs can be motivated by the fact that in these host countries the EMMs expect less competition and better chances to succeed than as if they would invest in an institutionally more developed country.

Finally, the institutional distance in terms of corruption has been widely investigated by previous studies (Lv & Spigarelli, 2016; Dikova et al. 2019). The previous empirical evidence showed that EMMs invest in countries with a deficient control of corruption (De Beule & Duanmu, 2012) and this is also in line with our findings that EMMs tend to invest in institutionally similar countries in terms of corruption.

Followingly, in the case of the second and the third hypothesis we are more focused on the direction of the FDIs by the EMMs. Based on Hennart's arguments, we wanted to find out what is the relationship between the institutional distance and the home market dominance and knowledge-based FSAs of the EMMs respectively.

As it is suggested also by the results of the regressions, both EMMs that are dominant on their domestic market and EMMs that have knowledge-based FSA, make FDIs into institutionally less developed host countries. The relationship between the variable of institutional distance and dominance and knowledge-based FSAs is significant a negative in most of the aspects of institutional distance described by the WGIs. There are no previous studies that consider the domestic market dominance of the EMMs, so we can't confront our results with other findings. Regarding the direction of the investments, the negative outcome is reasonable and confirming Hennart's theoretical explanation, because EMMs can efficiently acquire knowledge on the developed markets through acquisitions, but it has to follow a greenfield FDI strategy on the other emerging and less developed markets. On the other, the investments that are motivated by the exploitation of the knowledge related FSAs of the EMMs are found to be directed

towards institutionally less developed countries as it has been suggested by the literature (Demirbag et al. 2010).

Finally, we contribute to the location choice literature of the EMMs that is still to be explored. We connect it to the institutional theory to figure out the role of the institutional distance in the location choice of the EMMs. Moreover, we take an asymmetric approach to the institutional distance, accounting for its direction. In addition, we add further insights to the location choice of the EMMs regarding the FDI investments in institutionally similar countries.

Methodology contribution

In our analysis we relied on a unique dataset that has been developed by the merge of manually collected data about numerous foreign direct investments and firm level information, completed by county level data. As a result, we had a rich dataset with firms and investments from multiple home and host countries, both from developed and emerging ones.

In addition, so far the studies have implemented a symmetric view of institutional distance (Konara & Shirodkar, 2018), they focused on the magnitude of the institutional distance between the home and the host country, while its direction (positive or negative) has been only recently gaining research interest (Trapczynski & Banalieva, 2016). There are several studies that investigate the relationship of the institutional distance and subsidiary performance (Gaur et al. 2007), or ownership strategy (Brouthers, 2002) or even the survival of the foreign subsidiaries (Gaur & Lu, 2007). However, this study is the first which aims at incorporating the direction of the investment in terms of institutional distance into the location choice research.

Limitations and Future Research

Future research can draw upon the ideas described in this paper while addressing some of its limitations. First, by considering other type of firm-specific advantages such as marketing capabilities or technological superiority, a further test of the proposed theories could be done.

Second, our research strictly focused on the greenfield FDIs of the firms and delivered particular insights to these types of investments. However, it could be interesting to confront our results with brownfield investments (M&As) and to see whether the type of investments would influence the direction of the institutional distance between the home and the host country. Finally, knowing the motivations of these investments would permit to further understand the interdependencies between the institutional distance, the firm and its location choice.

Conclusion

The study aimed at advancing the theory on the EMMs by comparing and testing the various theoretical approaches, combining the theory of FSAs with the location choice literature. We focused on the location choice of the EMMs by analyzing the institutional similarity and the institutional distance between the home and the host countries of the FDIs. Thanks to our analysis, we found that the EMMs in most of the cases invest in countries with similar institutional environments. However, they also tend to invest in institutionally less developed countries both when they rely on their dominance on their domestic market and when they exploit their FSAs in other developing countries.

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TABLES

Table 1.

Similarity	PS	VA	GE	RQ	RL	CC
EMM	-0.447***	-0.750***	0.288**	-0.114	0.291**	0.584***
	(-3.62)	(-5.40)	(2.21)	(-0.84)	(2.09)	(4.52)
GDP/capita_host	0.013***	0.011***	0.024***	0.014***	0.017***	0.036***
	(4.66)	(3.70)	(7.78)	(4.81)	(5.70)	(10.61)
Population_host	-0.002***	-0.002***	-0.001***	-0.002***	-0.002***	-0.001***
	(-12.59)	(-15.06)	(-9.36)	(-11.46)	(-11.27)	(-7.97)
Technological development_host	0.559***	1.231***	0.863***	1.107***	1.224***	0.487***
	(9.88)	(17.37)	(13.99)	(17.09)	(17.88)	(8.03)
Trade openness_host	-0.002***	-0.007***	-0.004***	-0.002**	0.000	-0.002***
	(-3.64)	(-10.59)	(-5.99)	(-2.59)	(0.67)	(-2.80)
Log_Firm size	-0.024	-0.064***	-0.053***	-0.060***	-0.075***	-0.086***
	(-1.53)	(-3.54)	(-3.14)	(-3.42)	(-4.21)	(-5.16)
Log_Profitability	0.095**	-0.033	0.024	0.040	0.002	0.056
	(2.17)	(-0.68)	(0.54)	(0.82)	(0.05)	(1.22)
Leverage	0.000	0.000	0.000	0.002	0.003	0.003
	(0.21)	(0.20)	(0.27)	(0.89)	(1.16)	(1.18)
Geographic distance	0.000*	0.000***	0.000	0.000***	0.000	0.000
	(-1.76)	(-6.95)	(-0.18)	(-3.40)	(-0.01)	(0.18)
Common border	0.636***	1.151***	0.684***	0.802***	0.752***	0.66***1
	(4.40)	(6.25)	(4.61)	(5.01)	(4.67)	(4.52)
Common language	-0.178	0.747***	0.200*	0.760***	0.833***	0.414***
	(-1.50)	(5.49)	(1.63)	(5.81)	(6.15)	(3.38)
Colonial ties	0.520***	-0.201	0.515***	0.406***	0.261*	0.713***
	(4.09)	(-1.36)	(3.80)	(2.93)	(1.82)	(5.21)
_cons	-0.067	0.553**	-0.938***	-0.900***	-1.346***	-0.823***
	(-0.31)	(2.30)	(-4.13)	(-3.84)	(5.58)	(3.63)

Mean dependent var	0.452	SD dependent var	0.498
Pseudo r-squared	0.192	Number of obs	3224.000
Chi-square	854.016	Prob > chi2	0.000
Akaike crit. (AIC)	3629.544	Bayesian crit. (BIC)	3763.268

Presented are the standardized coefficients with z-value in parentheses. All model control for industry clusters and the year of the investment.

*** p<0.01, ** p<0.05, * p<0.1

Table 2.

Institutional distance	PS	VA	GE	RQ	RL	CC
Log_Dominance	-0.065*	-0.071	-0.040*	-0.053*	-0.045	-0.070**
	(-1.83)	(-1.54)	(-1.64)	(-1.87)	(-1.58)	(-2.35)
GDP/capita_host	0.159***	0.047	0.017***	0.017***	0.018***	0.022***
	(6.19)	(1.43)	(9.51)	(8.31)	(8.64)	(10.05)
Population_host	-0.002**	-0.001***	-0.001*	-0.004***	-0.003***	-0.003***
	(-2.17)	(-6.82)	(-1.68)	(-4.30)	(-3.60)	(-3.21)
Technological development_host	0.203***	0.533***	0.513***	0.420***	0.540***	0.496***
	(3.58)	(7.21)	(13.13)	(9.13)	(11.63)	(10.35)
Trade openness_host	0.003***	0.001	0.003***	0.003***	0.003***	0.003***
	(5.77)	(0.97)	(7.79)	(6.62)	(5.31)	(6.67)
Log_Firm size	0.072***	0.002	0.020	0.010	0.011	0.032*
	(3.48)	(0.09)	(1.38)	(0.62)	(0.66)	(1.82)
Log_Profitability	0.104**	0.011	0.063**	0.062*	0.039	0.087**
	(2.56)	(0.21)	(2.26)	(1.87)	(1.18)	(2.52)
Leverage	0.069*	0.043	0.063**	0.075**	0.063*	0.116***
	(1.74)	(0.83)	(2.33)	(2.33)	(1.96)	(3.47)
Global Challenger	-0.056	0.708***	0.009	0.150*	0.220**	0.134
	(-0.50)	(4.88)	(0.11)	(1.66)	(2.42)	(1.43)
Geographic distance	0.000	0.000***	0.000	0.000***	0.000**	0.000**
	(0.50)	(4.47)	(1.57)	(3.18)	(2.54)	(2.09)
Common border	-0.168	0.386***	-0.133*	-0.113	-0.075	-0.124
	(-1.53)	(2.70)	(-1.77)	(-1.27)	(-0.84)	(-1.34)
Common language	-0.338***	-0.304**	-0.153**	-0.088	-0.210***	-0.292***
	(-3.56)	(-2.46)	(-2.34)	(-1.15)	(-2.71)	(-3.56)
Colonial ties	0.353**	-0.027	0.239**	0.219*	0.375***	0.451***
	(2.35)	(-0.14)	(2.32)	(1.81)	(3.07)	(3.57)
_cons	-1.490***	-1.105***	-1.476***	-1.391***	-1.315***	-1.675***
	(-6.73)	(3.63)	(-9.19)	(-7.36)	(-6.88)	(-8.49)

Mean dependent var	0.452	SD dependent var		1.113
R-squared	0.504	Number of obs		429.000
F-test	17.873	Prob > F		0.000
Akaike crit. (AIC)	1053.993	Bayesian crit. (BIC)		1147.406

Presented are standardized coefficients with t-value in parentheses. All model control for industry clusters and the year of the investment.

*** p<0.01, ** p<0.05, * p<0.1

Table 3.

Institutional distance	PS.	VA	GE	RQ	RL	CC
Log_Knowledge based	-0.031*	0.017	-0.028**	-0.018	-0.033**	-0.058***
FSA	(-1.69)	(0.69)	(-2.22)	(-1.22)	(-2.18)	(-3.75)
GDP/capita_host	0.016***	0.002***	0.018***	0.020***	0.020***	0.023***
	(5.73)	(0.57)	(9.15)	(8.43)	(8.43)	(9.81)
Population_host	-0.003***	-0.001***	-0.001	-0.004***	-0.003***	-0.003***
	(-2.68)	(-6.10)	(-1.43)	(-3.92)	(-3.10)	(-3.17)
Technological	0.215***	0.602***	0.502***	0.395***	0.526***	0.473***
development_host	(3.65)	(7.72)	(12.28)	(8.13)	(10.73)	(9.42)
Trade openness_host	0.003***	0.001	0.003***	0.003***	0.002***	0.003***
	(4.60)	(1.17)	(6.79)	(5.40)	(4.34)	(5.32)
Log_Firm size	0.096***	-0.024	0.046**	0.025	0.043*	0.079***
	(3.51)	(-0.67)	(2.41)	(1.10)	(1.88)	(3.39)
Log_Profitability	0.109**	-0.034	0.033	0.033	0.007	0.057*
	(2.59)	(-0.61)	(1.13)	(0.94)	(0.20)	(1.61)
Leverage	0.072*	0.027	0.057**	0.067**	0.057*	0.112***
	(1.84)	(0.52)	(2.09)	(2.06)	(1.73)	(3.36)
Global Challenger	0.025	0.680***	0.030	0.152*	0.254***	0.210**
	(0.22)	(4.56)	(0.38)	(1.63)	(2.71)	(2.19)
Geographic distance	0.000	0.000***	0.000**	0.000***	0.000***	0.000***
	(0.74)	(4.06)	(2.04)	(3.39)	(2.69)	(2.84)
Common border	-0.087	0.368**	-0.098	-0.062	-0.021	-0.047
	(-0.77)	(2.46)	(-1.26)	(-0.67)	(-0.22)	(-0.49)
Common language	-0.296***	-0.361***	-0.086	-0.013	-0.148*	-0.196**
	(-2.96)	(-2.73)	(-1.24)	(-0.16)	(-1.78)	(-2.31)
Colonial ties	0.310**	0.022	0.251**	0.201	0.373***	0.454***
	(2.04)	(0.11)	(2.38)	(1.60)	(2.94)	(3.51)
_cons	-1.395***	-1.067***	-1.463***	-1.355***	-1.291***	-1.536***
	(-5.74)	(-3.31)	(-8.67)	(-6.75)	(-6.37)	(-7.42)

Mean dependent var	0.415	SD dependent var		1.106
R-squared	0.515	Number of obs		400.000
F-test	17.383	Prob > F		0.000
Akaike crit. (AIC)	970.754	Bayesian crit. (BIC)		1062.557

Presented are standardized coefficients with t-value in parenthesis. All model control for industry and the year of the investment.

*** p<0.01, ** p<0.05, * p<0.1

APPENDIX

Appendix 1.

World Governance Indicator	Definition
Political stability and absence of violence	the likelihood of political instability and/or politically motivated violence
Voice and Accountability	the extent to which a country's citizens are able to participate in selecting their government, as well as freedom of expression, freedom of association, and a free media
Government Effectiveness	the quality of public services, the quality of the civil service and the degree of its independence from political pressures, the quality of policy formulation and implementation, and the credibility of the government's commitment to such policies
Regulatory Quality	the ability of the government to formulate and implement sound policies and regulations that permit and promote private sector development
Rule of Law	the extent to which agents have confidence in and abide by the rules of society, and in particular the quality of contract enforcement, property rights, the police, and the courts, as well as the likelihood of crime and violence
Control of Corruption	the extent to which public power is exercised for private gain, including both petty and grand forms of corruption, as well as the state by elites and private interests

Appendix 2.

Variable	Operationalization	Source
Institutional distance	Measured on a scale of -2.5 to +2.5 by the World Governance Indicators	World Bank
EMM	Dummy variable 1 if the firm is an EMM, 0 otherwise	IMF
Log_Dominance	Natural logarithm of the average domestic revenue/average domestic revenue in the same sector in the same host country	Orbis
Log_Knowledge-based FSA	Natural logarithm of the Intangible fixed assets (thousand USD)	Orbis
Geographic distance	Distance measured between the most important cities/agglomerations of the home and the host country expressed in kilometers	CEPII
Common border	Dummy variable 1 if there is a common border between the home and the host country, 0 otherwise	CEPII
Common language	Dummy variable 1 if the home and the host country share a common official language, 0 otherwise	CEPII
Colonial ties	Dummy variable 1 if the home and the host country have colonial ties, 0 otherwise	CEPII

Technological development	R&D expenditure as a share of GDP of the country	Orbis
GDP per capita	Gross domestic product per capita expressed in thousand USD (PPP)	World Bank
Population	Population of the country expressed in million persons	World Bank
Export openness	Trade as a share of GDP of the host country	World Bank
Industry	Self-declaration by the firms	fDi Markets
Firm size	Natural logarithm of the number of employees of the firm	Orbis
Profitability	Natural logarithm of the operating revenue divided by the total sales	Orbis
Leverage	Shareholders' funds divided by the long-term debt of the firm	Orbis
Global Challenger	Dummy variable 1 if the firms is listed in as a global challenger, 0 otherwise	BCG

Appendix 3.

Variables	Mean	STD	(1)	(2)	(3)	(4)	(5)	(6)
(1) Similarity_PS	0.452	0.498	1.000					
(2) EMM	0.133	0.34	-0.084	1.000				
(3) GDP/capita_host	30272.94	20338.62	0.331	-0.086	1.000			
(4) Population_host	2.64e+08	4.47e+08	-0.313	-0.095	-0.392	1.000		
(5) Technological development	1.479	.936	0.285	-0.158	**0.503**	0.067	1.000	
(6) Trade openness_host	87.696	79.28	0.046	0.035	0.414	-0.285	-0.059	1.000
(7) Log_Firm size	8.183	2.709	-0.120	0.076	-0.174	0.093	-0.157	-0.059
(8) Log_Profitability	-.092	.99	0.071	-0.102	0.073	0.015	0.078	0.018
(9) Leverage	245.054	13720.47	0.019	-0.007	0.013	-0.008	0.025	0.000
(10) Geographic distance	5893.63	4282.479	-0.119	-0.091	-0.021	0.170	0.012	0.044
(11) Common border	0.115	0.32	0.148	0.147	0.043	-0.153	0.061	0.032
(12) Common language	0.204	0.403	0.048	0.048	0.131	-0.053	0.063	0.139
(13) Colonial ties	0.145	0.352	0.136	-0.068	0.134	-0.107	0.069	-0.017
(13) Industry	3.17	1.556	-0.017	-0.022	0.054	0.010	0.045	0.032
(14) Year	2002.24	2.07	0.001	-0.009	0.159	-0.071	0.129	0.038

Variables	(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)	(15)
(7) Log_Firm size	1.000								
(8) Log_Profitability	-0.025	1.000							
(9) Leverage	-0.022	0.267	1.000						
(10) Geographic distance	0.116	-0.030	-0.022	1.000					
(11) Common border	-0.047	0.022	-0.006	-0.413	1.000				
(12) Common language	0.013	-0.050	-0.009	0.086	0.168	1.000			
(13) Colonial ties	-0.104	-0.037	-0.007	0.035	0.022	0.399	1.000		
(14) Industry	-0.097	-0.091	-0.024	0.043	-0.002	0.096	0.080	1.000	
(15) Year	-0.094	0.014	0.015	-0.032	0.029	-0.057	-0.031	-0.007	1.000

Note: Bold correlations indicate significance at 5%