天津外国语大学（天外）
Tianjin Foreign Studies University (TFSU)

Geoeconomics & Regional Development

Online class starts at 08:00

(Beijing Time, GMT+8)

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March 13, 2023

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Topic 04
Influence of region, country and subnational-region institutions on internationalization of multinational corporations

Introduction

The decision of firms to expand operations into foreign markets is one of the most critical strategic decisions because it involves considerable resource commitments and risks. Traditional studies suggest that the industry structure primarily determines a firm's behavior and its long-term performance. The industry-based view thus argues that performance of firms varies due to different characteristics across industries.

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1. Introduction

When the firm’s operational boundary extends beyond its home country to other countries, further studies find that differences in the institutions across countries mainly contribute to the variation in behavior and performance of multinational corporations (Chan et al., 2008; Kittilaksanawong, 2017; Makino et al., 2004). More recent studies extend the influence of such institutional differences from country-level to lower-level subnational and higher-level supranational regions. These studies reveal that institutional differences indeed appear within a country and determine behavior and performance of a firm’s business units in different subnational regions (Chan et al., 2010; Ma et al., 2013). The studies emphasizing semiglobalization also find that formal institutions across supranational regions determine location choices and performance of a firm’s internationalization (Arregle et al., 2013; Qian et al., 2010).

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2. Country, industry, and firm effects

In the single country context, the performance of a business unit of firms is largely determined by the business unit itself, followed by the industry, and then by the corporate (McGahan & Porter, 1997). In the multinational context, a foreign affiliate is considered as both an integrated part of its parent firm in the home country and an independent local firm, competing with indigenous firms, while complying with local laws and regulations in the host country (Ghemawat, 2003). Similarly, the performance of foreign affiliates differs across industries in a host country and across countries in an industry. The performance of foreign affiliates is therefore influenced by the parent firm's firm-specific advantages and the host country's location-specific advantages.

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3 Effects of national institutions

The strategy and performance of foreign affiliates is not only influenced by such location-specific advantages and country-bound industry effects, but also by institutions in the host and the home country (Kostova & Zaheer, 1999; Peng et al., 2008). Institutions refer to the humanly devised rules of the game in a society (North, 1990). Together with the employed technology, institutions affect transaction and production costs and hence the profitability of firms. Since institutions are highly path dependent and localized processes in a country, their effects on firm performance vary across countries (Makino et al., 2004). While foreign affiliates are pressured to conform to institutions in the host country, they are also obliged to sustain internal consistency by responding to the institutional pressures imposed by their parent firm in the home country (Kostova & Zaheer, 1999).

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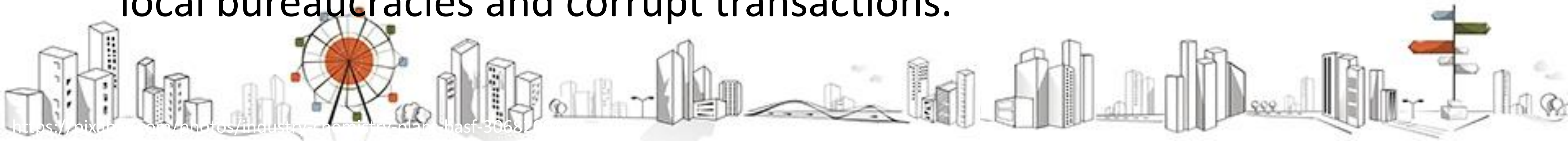
3 Effects of national institutions, part 2

In emerging economies, institutional rules are insufficient, poorly enforced, or even absent (Hitt et al., 2004; North, 1990). Foreign firms are more exposed to the risk of asset expropriation in these economies. They are likely to adopt inferior technology and suboptimal operations in response to underdeveloped property rights and uncertain contract enforcement (North, 1990). These firms have to protect possible unwanted dissemination of their intellectual and proprietary assets. Emerging economies usually lack reliable market information and intermediary institutions, hence increasing transaction costs of foreign firms operating in the market (Khanna & Palepu, 2000). Their operational efficiency tends to be compromised through engaging in local bureaucracies and corrupt transactions.



3 Effects of national institutions, part 3

Better-developed institutions are more able to determine what constitutes socially accepted organizational actions (Henisz, 2003; Hitt et al., 2004). Firms are likely to follow legitimate practices with more confidence in the outcome and chance of survival (DiMaggio & Powell, 1983). As such organizational practices are more institutionalized and adopted, the ability of firms to deal with institutional idiosyncrasies becomes less important (Peng, 2003).

4 Effects of subnational institutions

The performance of foreign affiliates varies greatly not only across countries with different levels of institutional development but also within countries, particularly within those that are large and that have a low level of institutional development (Chan et al., 2008; Chan et al., 2010; Ma et al., 2013). This effect comes from the embeddedness of foreign affiliates in the institutions of subnational regions within host countries. The governments in certain subnational regions may implement investment policies and offer preferential treatment to attract foreign investors. Subnational regions, particularly within a large emerging economy, may have distinct shared cultural values among society members, which affect the costs of doing business (Tung, 2008). These variations in formal and informal institutions thus create different opportunities and challenges that affect the performance of foreign affiliates.

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While regions with well-established institutions can facilitate competitive capabilities of foreign affiliates, those with underdeveloped institutions are likely to pose challenges to their strategic actions and performance (McEvily & Zaheer, 1999). Emerging economies are likely to have greater subnationalregion variations than advanced economies, leading to a wider difference in the performance of foreign affiliates (Chan et al., 2010). Governments in these economies are likely to make frequent changes in the policies and rules for investments and operations of foreign firms.

4 Effects of subnational institutions, part 2

The variation of foreign affiliate performance across subnational regions within host countries is due not only to institutional differences across subnational regions within host countries but also to the interaction effects of industry, parent firm, and home country of foreign affiliates with institutions within subnational regions (Ma et al., 2013). In particular, due to increased decentralization in many emerging economies, subnational-region governments may promote the development of certain industries in a subnational region (Kittilaksanawong et al., 2013; Li et al., 2014). Firms in a subnational region may be more advantageous in certain industries because that region is relatively rich in some specific production factors, including high-quality human capital.

4 Effects of subnational institutions, part 3

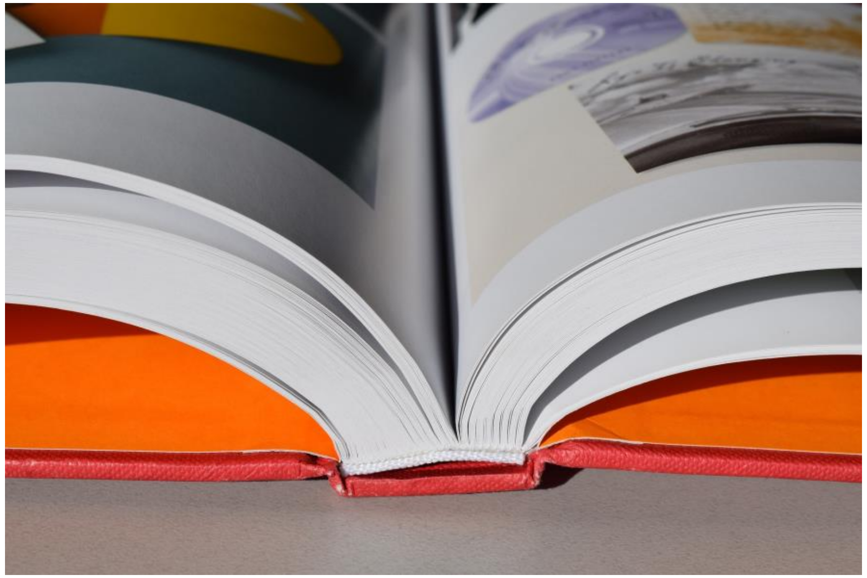
Subnational regions with highly educated talent may facilitate the transfer of firm-specific advantages such as technologies or brands from the parent firm to its foreign affiliates (Kogut & Zander, 1993). However, the crossborder transfer of firm-specific advantages may fail when the intellectual property protection in a subnational region is weak, or when the contractual enforcement law in the region is not effective.

4 Effects of subnational institutions, part 4

The home country of foreign affiliates in a subnational region of the host country affects their performance through institutional distance, historical ties, as well as geographic and linguistic distance (Ma et al., 2013). Large institutional distance requires that foreign affiliates heavily adapt their operational practices in the legal and social context within the subnational regions. The benefits from the foreign affiliate’s experience in the home regulatory institutions may therefore be compromised. Foreign affiliates may not readily exploit their home-based institutional experience and thus require new organizational learning in culturally distant subnational regions.

5 Effects of regional economic institutions

Supranational regions with stronger economic institutions are likely to attract more foreign direct investment (Dunning, 1988). Governments in these regions are likely to have the policies to make capital investments in the region and to provide various support for economic and market growth. Capital investments shape demand for and supply of resources in the economy, which create positive spillovers for foreign investors and, in turn, influence their strategic behavior and performance (Arregle et al., 2013). These investments provide opportunities for firms to learn and develop new technology and knowledge in the region. Such capital investments also support production expansion, research and development, and human capital development of foreign investors.



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5 Effects of regional economic institutions, part 2

- Such supranational-region expansion critically involves cumulative and time-consuming experiential learning from the market and networks to overcome the liability of foreignness in countries within the region (Johanson & Vahlne, 2009). Successful knowledge development is built on the firm’s absorptive capability that requires a degree of proximity between existing and new competences (Cohen & Levinthal, 1990). This sequential organizational learning allows firms gradually to accumulate knowledge and capabilities in proximate countries and use them in new emerging opportunities.

5 Effects of regional economic institutions, part 3

- Such a regional internationalization strategy therefore allows firms to focus more on markets within their home region, where they are likely to have better access to the country's location-specific advantages (Qian et al., 2010). Firms may also be able to combine these location-specific advantages with their own firm-specific advantages and realize higher performance. This intraregional strategy reduces various costs relating to coordination, transportation, and knowledge-sharing across different countries. Supranational regions and countries are different in their resource availability and munificence. Interregional internationalization strategy may, however, provide firms with more expansive learning opportunities through building, integrating, or reconfiguring such different resources and capabilities (Lee & Makhija, 2009).

5 Effects of regional economic institutions, part 3

- Individual income tax rate for the Tax residents are 13%, 15%
- Individual income tax rate for the non Tax residents is 30%
- 183 days
- 0-45%

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5 Effects of regional economic institutions, part 4

- As firms engage in greater levels of inter-regional internationalization, they face challenges in optimally distributing their resources between the often less costly and more focused intra-regional investments and the continuing interregional investments. More focused investment in certain countries and regions may be necessary to mitigate costs and risks of inter-regional internationalization. Therefore, firms are likely to achieve the highest performance at moderate levels of inter-regional internationalization (Qian et al., 2010).

6 Discussion and implications

Institutions at country, subnational-region, and supranational-region levels influence the strategy and performance of multinational companies and their foreign affiliates (Arregle et al., 2013; Chan et al., 2008; Chan et al., 2010; Kittilaksanawong, 2017; Ma et al., 2013; Makino et al., 2004; Peng et al., 2008; Qian et al., 2010). The country effects are as influential as industry effects, following affiliate and corporate effects (Makino et al., 2004). Further, the country effects tend to be more salient in institutionally underdeveloped countries, while corporate effects are likely to be more pronounced in developed countries (Chan et al., 2008). The performance of foreign affiliates also varies across subnational regions within a country (Chan et al., 2010). Further, the performance of these foreign affiliates within a subnational region also varies across industries, corporate parents, and home countries (Ma et al., 2013). These subnational regional differences are more influential to the performance of firms particularly in large emerging economies.

6 Discussion and implications, part 2

In emerging economies, foreign affiliates need to have the ability to handle and overcome their institutional idiosyncrasies (Henisz, 2003). Such ability involves developing direct and indirect ties with governments and other firms. As the institutional environments of subnational regions, particularly in large emerging economies, may vary considerably, firm-specific advantages are necessary, but not a sufficient condition for firms to succeed in these economies.

6 Discussion and implications, part 3

Governments in emerging economies should advance the process of institutional development, and establish trading agreements and investment regulations to attract inward foreign direct investment, known to increase productivity and create new jobs. Policymakers should be able to identify which subnational regions require specific policies and government investments to attract foreign investors. They should consider whether to consolidate certain industries in one subnational region or distribute them across subnational regions

6 Discussion and implications, part 4

The strategy and performance of foreign affiliates varies within intra- and inter-regional countries (Arregle et al., 2013; Qian et al., 2010). Multinational companies should consider institutional environments at the regional level in their investment decisions. They should view the institutional environments of a country in relation to those of other countries in the same or different regions in their investment decisions. They should capitalize on the coordination and learning benefits to develop region-bound, firm-specific advantages from their investments within a region as a platform for subsequent investments in countries within this region (Arregle et al., 2013)

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Mendeley

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JOURNAL ARTICLE

Do regions matter? An integrated institutional and semiglobalization perspective on the internationalization of MNEs

Arregle J, Miller T, Hitt M et al. See more

Strategic Management Journal (2013) 34(8) 910-934

DOI: 10.1002/smj.2051

Task 1

Please, read one of the agreements listed below:
PDF version of the agreements have been sent to you in our Chat.

AGREEMENT
BETWEEN
THE GOVERNMENT OF THE PEOPLE'S REPUBLIC OF CHINA AND
THE GOVERNMENT OF THE PEOPLE'S REPUBLIC OF BULGARIA
FOR THE AVOIDANCE OF DOUBLE TAXATION AND
THE PREVENTION OF FISCAL EVASION WITH RESPECT
TO TAXES ON INCOME AND CAPITAL

AGREEMENT
BETWEEN THE GOVERNMENT OF THE PEOPLE'S REPUBLIC OF CHINA
AND THE GOVERNMENT OF THE RUSSIAN FEDERATION
FOR THE AVOIDANCE OF DOUBLE TAXATION
AND THE PREVENTION OF FISCAL EVASION
WITH RESPECT TO TAXES ON INCOME

AGREEMENT
BETWEEN
THE GOVERNMENT OF THE PEOPLE'S REPUBLIC OF CHINA AND
THE GOVERNMENT OF THE PEOPLE'S REPUBLIC OF BULGARIA
FOR THE AVOIDANCE OF DOUBLE TAXATION AND
THE PREVENTION OF FISCAL EVASION WITH RESPECT
TO TAXES ON INCOME AND CAPITAL

The Government of the People's Republic of China and the Government of the People's Republic of Bulgaria;

Desiring to promote and deepen the economic cooperation between the People's Republic of China and the People's Republic of Bulgaria in accordance with the principle of equality and mutual benefit, through an Agreement for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and capital;

Have agreed as follows:

ARTICLE 1
PERSONAL SCOPE

This Agreement shall apply to persons who are residents of one or both of the Contracting States.

ARTICLE 2
TAXES COVERED

1. This Agreement shall apply to taxes on income and on capital imposed on behalf of a Contracting State or of its local authorities irrespective of the manner in which they are levied.

2. There shall be regarded as taxes on income and on capital all taxes imposed on total income and on total capital, or on elements of income or of capital, including taxes on gains from the alienation of movable or immovable property, as well as taxes on capital appreciation.

3. The existing taxes to which the Agreement shall apply are:

(a) in the People's Republic of China:

1

AGREEMENT
BETWEEN THE GOVERNMENT OF THE PEOPLE'S REPUBLIC OF CHINA
AND THE GOVERNMENT OF THE RUSSIAN FEDERATION
FOR THE AVOIDANCE OF DOUBLE TAXATION
AND THE PREVENTION OF FISCAL EVASION
WITH RESPECT TO TAXES ON INCOME

The Government of the People's Republic of China and the Government of the Russian Federation,

Desiring to conclude an Agreement for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income,

Have agreed as follows:

ARTICLE 1
PERSONS COVERED

This Agreement shall apply to persons who are residents of one or both of the Contracting States.

ARTICLE 2
TAXES COVERED

1. This Agreement shall apply to taxes on income imposed on behalf of a Contracting State or of its political subdivisions or local authorities, irrespective of the manner in which they are levied.

2. There shall be regarded as taxes on income all taxes imposed on total income, or on elements of income, including taxes on gains from the alienation of movable or immovable property and taxes on the total amounts of wages or salaries paid by enterprises.

3. The existing taxes to which the Agreement shall apply are in particular:

a) in China:
(i) the individual income tax;
(ii) the enterprise income tax
(hereinafter referred to as "Chinese tax");
b) in Russia:
(i) the tax on profits of organizations;
(ii) the tax on income of individuals
(hereinafter referred to as "Russian tax").

4. The Agreement shall apply also to any identical or substantially similar taxes that are imposed after the date of signature of the Agreement in addition to, or in place of, the existing

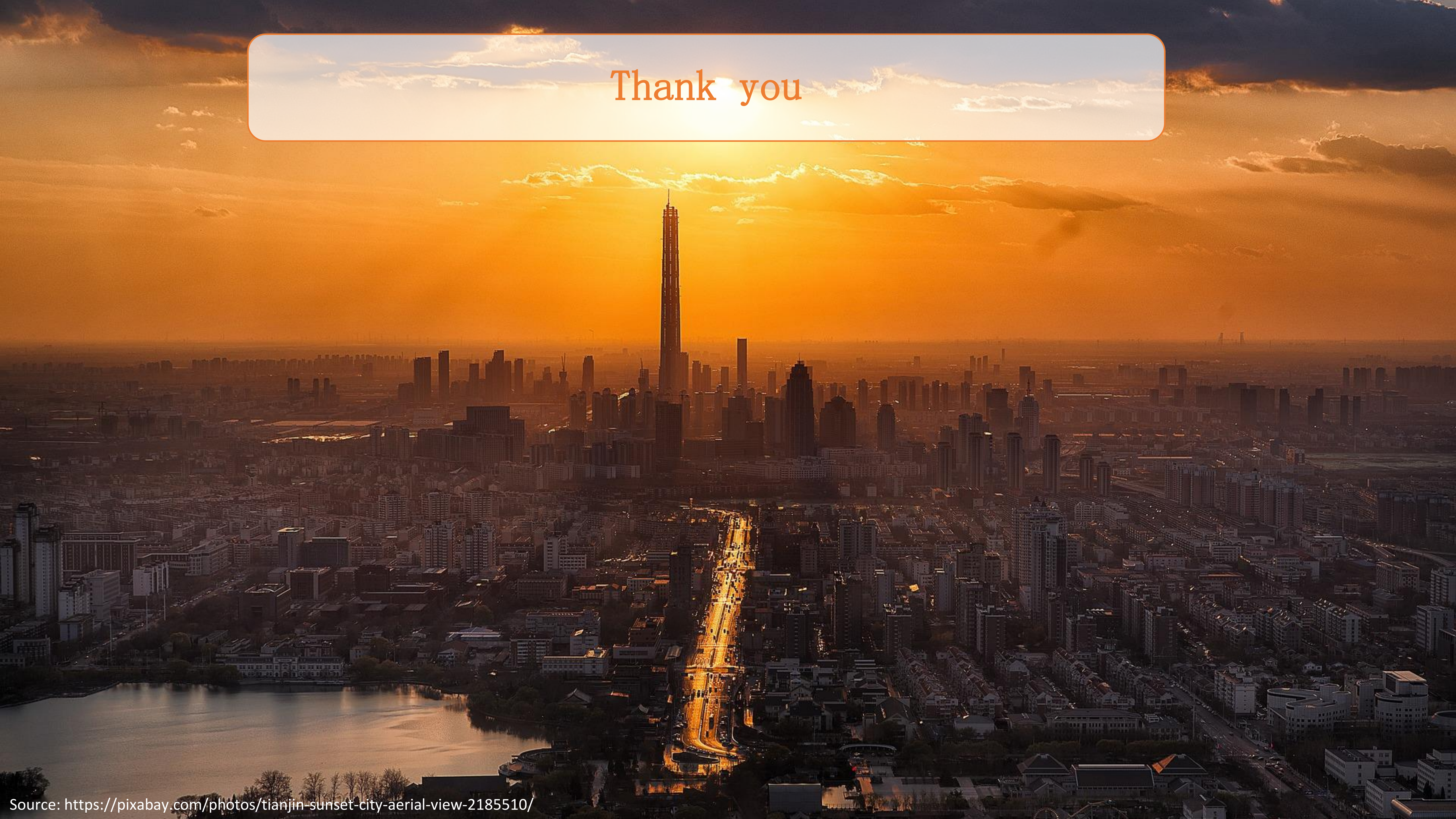
—1—

Share your thoughts on the importance of such bilateral agreements for international cooperation between the countries.

Chenyang Wu
It's pivotal because it can boost the cooperation. For example, the term of the teaching states that teachers are exempt of tax for the first-mentioned country for five years upon the arrival, which can promote the education communication and bring the effect of knowledge spillover.
Ivan

12:28

Xinke Jiao
It reduces trade barriers and facilitates firms' cooperation between countries. It also avoids discrimination and transnational tax evasion. It is standard and easier to carry out.
210710ZhengyuFang
I think it has positive significance to international cooperation between two countries. It reduces the economic costs of cooperation between the two countries, helps the economic exchanges between the two countries, and makes the international relations more friendly.



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