# Emergent Strategies in Emerging Economies:
# From Investment Motives to Subsidiary Strategy

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**Abstract**

Businesses frequently reassess and modify their strategies in response to changing environments. This applies in particular to subsidiaries in emerging economies faced with rapidly evolving institutional frameworks. In consequence, realized subsidiary strategies may deviate from the initial intended strategy. Thus, a subsidiary set up with competence-creating motivations may not always implement a strategy that is based on exploring locally acquired resources.

We integrate the Internationalization Process in the tradition of Johanson and Vahlne with Mintzberg's emergent strategy perspective to investigate this phenomenon. We propose and test a conceptual framework concerning the contingencies that may lead foreign investors to deviate from their original intentions, and either enhance or reduce the scope of their subsidiary. In a study of 329 subsidiaries in three Central and East European countries, we find that both strategic and institutional influences have moderating effects on firm deviation from their original entry motives. In particular, scope reduction is found to be more likely for local market oriented investors, and in institutional contexts that support market efficiency and that are improving over time.

**Keywords**: internationalization process, emergent strategy, institutions, business and corporate strategy, emerging economies.

## 1. Introduction

Why do multinational enterprises (MNEs) modify their objectives while establishing subsidiaries abroad? This paper analyzes why investors' initial foreign entry motives may differ from the strategy they eventually realize in their new subsidiary. In particular, we are concerned with subsidiaries set up in pursuit of competence-creating entry motives that may or may not implement strategies exploring intangible and locally contributed resources (hereafter competence-creating strategies). The successful implementation of a competence-creating strategy would be a basis for a subsidiary to create its own competitive advantages (Amit and Schoemaker 1993, Peteraf 1993) and eventually attain world mandate development (Birkinshaw and Hood 1998, Cantwell and Mudambi 2005).

The internationalization process (IP) model of Johanson and Vahlne's (1977) provides a foundation for process oriented research on international business. It has stimulated several lines of inquiry, including the study of experiential knowledge (Kogut and Zander 1993), global learning and the creation of new competitive advantages through international operations (Bartlett and Ghoshal 1989, Forsgren 1989). The model has variously been extended, for instance, to incorporate the internationalization of business networks (Johanson and Vahlne 1990, 2003) and of opportunity creation and discovery (Johanson and Vahlne 2006, Johanson and Johanson 2006).

However, empirical studies provide only mixed support. Some studies provide supportive evidence (Welch and Loustarien 1988, Young *et al*. 1996, Eriksson *et al*. 1997), while others find no support to the model (Turnbull 1987, Sullivan and Bauerschmidt 1990, Benito and Grusprud 1992, Fina and Rugman 1996). The model has been criticized for being overly deterministic, for lacking consideration of the external environment, for its limited application of organizational learning, for its limited focus on the initial stages of internationalization and for its failure to consider acquisitions as a mode of international growth (e.g. Melin 1992, van de Ven 1992, Andersen 1993, Hadjikhani 1997, Forsgren 2002). Nonetheless, the dynamics of the IP model are particularly relevant for explaining processes of MNE entry and growth in transition economies due to the dynamic nature of the context, which necessitates ongoing learning processes to support increases of commitment

(Meyer and Gelbuda 2006, Johanson 2008, Jansson and Sandberg 2008). Consequently, process theories may be more appropriate to analyze the evolution of business strategies in contexts of high volatility and uncertainty, such as transition economies, because they model change processes within firms and their environment as continuous learning.

In this paper, we aim to address two shortcomings of the IP model. Firstly, it conceptualizes internationalization as a unidirectional process of gradually deepening commitment. Given the model's life cycle character (Forsgren 2002), internationalization is conceived as a unitary progression over a sequence of *a priori* prescribed phases (Melin 1992). Consequently, the IP model does not allow for reductions in the commitments of foreign investors. Secondly, the model lacks a strategic dimension, i.e. upgrade decisions are taken one at a time as information becomes available, but there is no role of strategic intent. Strategic decision-making is explicitly ruled out in the model as it "expects that the internationalization process, once it has started, will tend to proceed regardless of whether strategic decisions in that direction are made or not" (Johanson and Valhne 1990, 12). However, as MNEs learn about a local context, they can deviate from their previously envisaged strategic plan in two ways: they can enhance the scope, and they can reduce the scope. Such decisions are made while the strategy is being realized; the strategy of a young subsidiary thus is, in large part, an emergent strategy (Mintzberg and Waters 1985). In other words, it arises as a behavioral pattern realized despite of intensions (Mintzberg 1978). Such an emergent element in strategy implementation is particularly likely in contexts previously unfamiliar to investors, and in contexts of high volatility – conditions that apply in transition economies. Principally, we would expect that discrepancies between original motives and realized strategies are frequent because businesses naturally adapt to changes in their environment, yet their propensity for adjustment would vary across firms and across environments.

Along these lines, we argue that the integration of the emergent strategy perspective into the IP model enables to address the two shortcomings discussed above and thus to enhance the model's explanatory power. First, the emergent strategy logic explains why reductions in the firm's internationalization commitment may occur as emergent elements come to dominate over initial intentions. Second, the incorporation of the emergent strategy perspective recognizes that firms have a strategic intend, which they may or may not realize. To this end, we assess the influence of corporate and institutional influences in subsidiary emergent strategies. In particular, we explore two sets of factors that contribute to strategy deviation from original investment motives, namely factors related to strategic learning and the breadth of corporate capabilities, and factors related to the local institutional environment. We follow suggestions in prior management research (Olivier 1997; Newman 2000) and in studies on business in emerging economies (Meyer and Peng 2005, Wright *et al*. 2005) to integrate the strategy perspective, based upon organizational learning theory and the resource-based view, with the institutional perspective. Our empirical findings confirm the complementarity of these two perspectives and support to the effects of strategic and institutional influences on emergent strategies.

Hence, we offer three contributions. First, we add theoretical depth to the IP model by incorporating the emergent strategy perspective into the model. This integration enhances the model's explanatory power, and extends it to a number of situations formerly left out. Second, we contribute to the literature on emerging economies by confirming the complementary contributions of the strategic and institutional perspectives. Third, we contribute to the IB field by demonstrating how the inclusion of strategic considerations in IB models sharpens the understanding of internationalization. Finally, we make a methodological contribution by showing how exposure to institutional obstacles can be measured at the firm level, thus advancing over literature that has largely relied on country-level proxies.

## 2. Theoretical foundations

### *Emergent Internationalization*

The IP model explains firm's internationalization as a sequential process whereby the present state of internationalization (i.e. commitment to and knowledge about the foreign market) is an important factor explaining the future path of internationalization. In this model, commitment decisions and current business activities are aligned in the sense that commitment decisions are made in response to perceived opportunities and challenges. Firms' international expansions are thus mechanically related to current business activities. But, there may well be cases where there is a mismatch between firms' perceptions driving entry motives, on the one hand, and subsidiary current business activity, on the other. Later revisions of the model have emphasized the role of opportunity development (Johanson and Vahlne 2006) and network relationships (Johanson and Vahlne 1990, 2003) in internationalization decisions. However, as far as we know, no analysis has been carried out on whether commitment decisions are then *de facto* realized.

The concept of 'emergent strategy' (Mintzberg 1978, Mintzberg and Waters 1985) provides a missing link to this argument. This concept has been developed based on Mintzberg's (1972) insight that strategy needs to be more realistically understood as a pattern in a stream of decisions rather than in terms of intentions (Chandler 1962). Mintzberg and Waters (1985, 247) thus distinguish between "*deliberate* strategies – realized as intended – from *emergent* strategies – patterns or consistencies realized despite, or in absence of intensions" (Figure 1).

INSERT FIGURE 1 HERE

Decision makers have limited foresight due to bounded rationality and uncertainty. They may thus fail to implement their intended strategy, such that the realized strategy is only to a limited degree a deliberate strategy, but to a large extend an emergent strategy. Specifically, foreign investors may not realize their strategic (or non-strategic) entry motives as intended and realize instead a non-competence-creating (or competence-creating) subsidiary strategy, i.e. an emergent strategy. In these cases of scope reduction (or enhancement), we investigate why the realized subsidiary strategy is inconsistent with the original entry motives. The 2x2 matrix in Figure 2 illustrates the possible combinations of presence or absence of competence-creating entry motives and competence-creating subsidiary strategies. The top-left to bottom-right diagonal refers to the situation considered in Johanson and Vahlne's IP model, namely the implementation of a strategy on the basis of stepwise acquired local knowledge (i.e. deliberate strategy). Firms do however deviate from this pattern; thus we explore the determinants of situations in the off-diagonal cells of the matrix (i.e. top-right and bottom-left boxes). In particular, we ask *which factors are driving divergences between entry motives and realized subsidiary strategy (i.e. emergent strategy)?*

INSERT FIGURE 2

If firms have incomplete information and operate in unpredictable environments, deliberate strategies are unlikely (Mintzberg and Water 1985).[i] This holds in particular true in institutional contexts of environmental uncertainty and high volatility. In consequence, it is important for firms to engage in strategic learning (that is, learning to adapt to messages from the environment), and to develop capabilities that enable coping with incomplete and rapidly evolving information. Hence, original entry motives may diverge and the realized subsidiary strategy can arise from strategic and institutional influences. Our conceptual model is summarized in Figure 3 where a subsidiary strategy may be realized either as intended at time of entry (scope fit), or by reducing or enhancing the scope of the original entry motives as a result of corporate and institutional influences.

INSERT FIGURE 3

***Organizational Learning Perspectives***

The concept of strategic learning has been developed in the organizational learning literature (Fiol and Lyles 1985, Huber 1991, March and Levitt 1999) drawing on organizational theory, psychology and sociology. Organizational learning moves from the recognition that organizations, like individuals[ii], are unable to perfectly foresee the outcome of their decisions due to lack of information and limited computational and cognitive capabilities (Simon 1955). Like individuals, organizational rationality is, therefore, bounded by incompleteness of the information set and of knowledge (Simon 1976). Thus, chosen actions are not necessary the best in the set of all feasible possibilities since organizations only choose among what they know and not on the full set of alternatives (Alchian 1950). This implies that organizational action proceeds by trial and error. Along these lines, research in organizational learning has emphasized that organizations learn by modifying their behavior in response to information processing (Huber 1991). Prior to information processing, a major requirement for learning to take place is the acquisition of knowledge, which heavily depends on existing knowledge within the firm (Lyles and Salk 1996, Simonin 1999, Lane *et al*. 2001). Firm's prior knowledge enables the organization to absorb recognized new valuable knowledge (Cohen and Levinthal 1990) and to integrate it into the firm and use it productively (Lane and Lubatkin 1998).

In the context of transition economies, organizational learning has been recognized to be complementary to the resource-based view (Lyles and Salk, 1996; Uhlenbruck *et al*. 2003, Dixon *et al.* 2009). Firm's learning amplifies intangible resources and the possible strategies the firm can employ (Hitt *et al*. 1997, Huber 1991). Accumulation of valuable, unique and difficult to imitate resources provides the basis for firm's competitive advantage (Barney 1991, Amit and Schoemaker 1993, Peteraf 1993). In more recent developments of the resource-based perspective (Teece *et al*. 1997), resources accumulation allows to develop dynamic capabilities which enable firms to develop new related resources and exploit new opportunities from existing capabilities through a path-dependent learning process (Prahalad and Hamel 1990). In the resource-based view, resources are then the drivers of firm growth which is accomplished through diversification and internationalization by expanding corporate capabilities into new related fields and markets respectively (Penrose 1959, Geringer *et al*. 1989, Rugman and Verbeke 2002), that is increasing the breadth of corporate capabilities across products and geographical markets.

***Institutional Perspectives***

In the IB literature, institutions were initially introduced as a location advantage within the OLI paradigm (Dunning 1993), within which they gain increasing recognition in recent years (Dunning 1998, Dunning and Lundan 2008). Recent work in the strategy field has increasingly suggested that corporate strategies are moderated by the specific characteristics of the context in which firms operate (Hoskinsson *et al*. 2000, Ingram and Silverman 2002, Meyer and Peng 2005, Tsui 2004, Meyer 2007). The incisive influence of institutions on the formulation and implementation of corporate strategy has been mainly suggested in the context of emerging economies, where institutional frameworks are markedly different from developed economies (Khanna *et al*. 2005, Meyer and Peng 2005, Wright *et al*. 2005). In particular, it has been argued that institutions can facilitate or inhibit foreign investors to access complementary resources (Peng 2003; Meyer, Estrin, Bhaumik and Peng 2009), affect preferred governance structures (Makino and Beamish 1998) and influence investors perceived risks (Brouthers 2002).

This stream of research has advanced knowledge on the influence of macro-level institutions on transaction costs (Acemoglu *et al*. 2001, North 1990), which was left largely unexplored by traditional transaction costs research (e.g. Williamson 1985). Focusing mainly on opportunism and bounded rationality, the former treated institutions as background conditions. However, weak property rights and high enforcement costs make transaction costs particularly high in emerging economies (and transition economies as a specific case) (La Porta *et al*. 1999). In these contexts, further institutional costs may also derive from administrative inefficiency and corruption. As a consequence, transition economies are characterized by high uncertainty and information asymmetries, and foreign operations in these environments need to devote more resources to information searching (Meyer and Peng, 2005; Tong *et al*. 2008).

However, the institutional environment in transition economies evolves over time (Chung and Beamish 2005). Improvements and strengthening of the institutional framework may lower the costs of doing business by facilitating the development of resources and capabilities that contribute to the subsidiary's successful performance. On the other hand, it has also been pointed out that changes in the institutional framework may require strategy modification by foreign investors (Bevan *et al*. 2004, Meyer and Nguyen 2005) which may in turn imply additional transaction costs linked to the instability and unpredictability of the institutional environment (Swaan 1997, Meyer and Peng 2005).

## 3. Hypotheses

Our core argument is that strategic and institutional factors have different influences on emergent strategies in emerging markets.

***Business and Corporate Strategy***

In absence of complete information, firms need to link to the local environment in order to learn about local opportunities and obstacles (Fiol and Lyles 1985) for the sake of superior commercial value creation. To this end, they need to acquire and process new knowledge, which may be easier to achieve by young foreign subsidiaries oriented toward the local market since they can learn more easily about the local environment and accumulate tacit knowledge (Slater and Narver 1995). Prior studies (e.g. Martinez and Jarillo 1991, Harzing 1999, Taggart 1998, Rugman and Verbeke 2001) discovered that local market-oriented subsidiaries tend to have higher autonomy. In general, subsidiaries have higher autonomy over decisions where they have superior information in the sense that they understand the local market better than decision makers at headquarters (Holm and Pedersen 2000).

Due to information asymmetries (Roth and O'Donnel 1996, Tsaluk et al. 2006), market-oriented subsidiaries have an information advantage vis-a-vis headquarters when headquarters would suggest a scope reduction (say, because of forecasts of low market growth). In contrast, an export oriented subsidiary is by its nature normally competing with other units of the MNEs' global network for orders and has less information advantages vis-a-vis the headquarter with respect to market outside the local economy (Roth and O'Donnel 1996). In this later scenario, shifts in the parent's global strategy (say, in response to shifts in relative costs due to exchange rate movements) would thus directly impact on the subsidiary. Hence, we suggest that local market orientation makes it less likely that the subsidiary may be asked to reduce its scope. Thus our first hypothesis is:

*H1a: The greater the local market orientation of the subsidiary, the less likely that the subsidiary adopts an emergent scope-reducing strategy rather than a scope-fitting strategy.*

The greater autonomy of a local market oriented subsidiary also enhances its opportunity to achieve scope enhancement. In the local market, the subsidiary is in a superior situation with respect to opportunity recognition and assessment. Moreover, a successful subsidiary may also generate internal resources that allow it to invest in scope enhancement. Local market orientation has been shown to enhance learning from customers and competitors, and thus subsidiary performance (Deshpande et al. 1993, Jaworski and Kohli 1993, Narver and Slater 1990, Ruekert 1992, Slater and Narver 1994, 2000). Successful subsidiaries can use these resources, and their information advantage, to maintain or even increase the scope of their operations and competences, perhaps even achieving mandates that go beyond the local market (Birkinshaw and Hood 1998). Hence, local market orientation makes the enhancement of subsidiary scope more likely.

*H1b: The greater the local market orientation of the firm, the more likely that the subsidiary adopts an emergent scope-enhancing strategy rather than a scope-fitting strategy.*

MNEs can learn about the foreign environment also by diversifying corporate knowledge in related lines of business so to better identify opportunities and obstacles in foreign markets (Hitt *et al*. 1997). The resource-based view (Barney 1991) explains firms' competitive advantages with the internal capabilities of a firm and suggests that diversification into related lines of business will be profitable to the extent that it will generate economies of scope by relying on the firm's existing "rent-yielding" resources. Successful diversified firms are able to leverage core resources across related business and generate competitive advantage through scope effects. This implies that product diversity enables firms to identify opportunities in foreign markets yielding to superior corporate subsidiary performance (Hitt *et al*. 1997), while focused firms lack capabilities on and knowledge of different lines of business as a result of their narrow market focus. Thus, multinationals focusing on one main line of business only are less likely to enhance the scope of a subsidiary by realizing a competence-creating strategy.

*H2: The likelihood that the subsidiary adopts an emergent scope-enhancing strategy rather than a scope-fitting strategy is lower when parent's operations are focused on one main business.*

***Institutional influences***

Doing business in emerging economies exposes multinational enterprises to local contexts where markets are not as efficient as in mature market economies (Khanna and Palepu 2001, Peng 2003, Meyer and Peng 2005). One way to reduce risk is to generate more accurate expectations on institutional issues (Arrow 1972, Henisz 2002). Internationally available Information on institutional obstacles, documented by specialized organizations and institutions (such as the EBRD annual reports), may help to improve expectations. This implies that, when foreign firms enter in these countries, they are usually well documented on host institutional obstacles and these can hardly affect their subsequent subsidiary performance. In consequence, foreign investors would design their subsidiary strategy more carefully.

Moreover, if institutional obstacles make doing business more costly, then also changing a business would incur more adjustment costs (Reid 1999). In particular, as business environments are volatile, businesses would engage in continuous adjustments if they are free to do so (Peng and Heath 1996) However, when institutional obstacles in the host economy reduce flexibility by increasing transaction costs, adjustments are costly. This yields an inertial behavior by firms making changes of scope less likely in any direction (i.e. scope enhancement or reduction). Hence, we propose:

*H3a: The greater the institutional obstacles in the host market, the less likely that the subsidiary adopts an emergent scope-reducing strategy than a scope-fitting strategy.*

*H3b: The greater the institutional obstacles in the host market, the less likely that the subsidiary adopts an emergent scope-enhancing strategy than a scope-fitting strategy.*

Institutional change in transition economies is generally associated with improvements in the business environment. However, they may also increase transaction costs, at least in the short run, by making the institutional framework less predictable and less stable (Swaan 1997, Meyer and Peng 2005). Moreover, political uncertainty – that is uncertainty over political actions that may affect the profitability of a business operation – plays a significant role in firms' investment and behavior (Henisz 2000, 2002). Greater environmental complexity and dynamism may also provoke an information overload and learning may not take place (Lawrence and Dyer 1983). Therefore, competence-creating motivated firms are more likely to realize an emergent scope-reducing subsidiary strategy also when institutional improvements are greater due to higher transaction costs and information overload raised by institutional instability. On the other hand, institutional improvements may favor emergent scope-enhancing subsidiary strategies for non competence-creating motivated firms by improving the business environment. Hence, institutional improvements in the host economy make it easier for subsidiary to change their strategy, and they create changes in business opportunities that make adjustments more likely to be required. Hence, we expect that improvements in the institutional environment are associated with changes in subsidiary scope, which may results in both scope reductions and scope enhancement.

*H4a: The greater the institutional improvements in the host market, the more likely that the subsidiary adopts an emergent scope-reducing strategy than a scope-fitting strategy.*

*H4b: The greater the institutional improvements in the host market, the more likely that the subsidiary adopts an emergent scope-enhancing strategy than a scope-fitting strategy.*

## 4. Methodology

### *4.1. Data*

The empirical analysis is based on a questionnaire survey administered by local research teams in three countries in CEE in 2003: Hungary, Poland and Lithuania.[iii] The reason for focusing on transition economies is twofold. First of all, a sharp increase in inward-FDI in CEE countries since the early 1990s from negligible levels provides an opportunity to investigate the evolution of FDI from its outset (Meyer and Peng 2005). Second, these three countries experienced similar transition processes with high FDI potential and performance (UNCTAD 2005). All three countries have been increasingly attracting FDI on the basis of human capital, with low-skill based FDI increasingly locating to countries outside the European Union. Moreover, they have experienced dramatic institutional changes and a consequent volatile environment (EBRD 2003, World Bank 2004) that require adaptation and continuous learning from foreign investors, which are crucial features we aim to investigate in our study.

The base population of our research included all FDI projects established from 1990 to 2002, which have at least 10 employees and foreign equity participation of at least 10 percent, as per the OECD definition of FDI (OECD 1996). The survey's sample frame was constructed from multiple locally available databases to maximize the coverage of FDI given the lack of complete databases of FDI projects in these countries. The research questions and instruments were designed and developed after three meetings of the research teams. Then, the questionnaire was translated into local languages and sent to the respondents in both languages. The questionnaire was sent to the chief executive of each foreign subsidiary for which contact information was available in the database. In most cases, this was followed up with telephone calls and personal interviews. We obtained responses from 535 representing a response rate of over 13 percent. These comprised 200 in Poland, 111 in Lithuania and 224 in Hungary (representing response rates of 10%, 11% and 22% respectively). The databases often reported very imprecise firm information, such that some contacted firms were not actually in operation (especially in Poland) or not actually foreign-owned (in Hungary), and should theoretically not have been in the sample frame. Thus the aforementioned response rates are low estimates.

***Variables***

***Dependent variable***. Our dependent variable is *emergent strategy*, that is the divergence between firm's entry motives and realized subsidiary strategy. Following Mintzberg (1978), we view strategy as a pattern in the organization's decisions and actions, and we look at organizational goals and the allocation of resources necessary to achieve these goals (Snow and Hambrik 1980). Our dependent variable thus is constructed in four steps.

First, we classify entry motives as competence-creating or non competence-creating. Respondents were ask to rate the importance of alterative entry motives on Likert scales. Two of them related to competence-creating motives (access to skills and control over assets), while three relate to non-competence creating motives (access to markets or cheap labor, and improvement of efficiency). If the average score over the competence-creating items was larger than the average score over the non-competence-creating items, then an entry was classified as 'competence-creating motive'.

Second, we looked at the MNE realized strategy using an instrument introduced by Meyer, Estrin Bhaumik and Peng (2009) based on two questions. In the first place, respondents were asked to identify their most important resource. Then, they had to indicate in percentages where this resource came from. If the resource was intangible, and from local sources (e.g. a partner firm), then the realized strategy was classified as 'competence creating'. Otherwise it was classified as non-competence-creating strategy. This measurement is in line with studies on MNE subsidiaries (Nobel and Birkinshaw 1998, Kuemmerle 1999, Pearce 1999, Cantwell and Mudambi 2005) which point out that competence-creating subsidiaries locally acquire and maintain valuable idiosyncratic resources to enhance the MNE's sustainable advantage, while non-competence-creating subsidiaries primarily rely on the parent's existing resources for the sake of market customization.

Our focal variable however relates to the change between the initial motive and the realized subsidiary strategy to disentangle deliberate and emergent strategies, as illustrated in Figure 1. The third step thus brings these two dummy variables together. A strategy was classified as *deliberate* strategy, or *scope-fitting strategy* when the two dummies matched. This is the case when competence-creating motives lead to a realized competence-creating strategy (top-left cell in Figure 2), or when non-competence-creating motives lead to a realized non-competence-creating strategy (bottom-right cell in Figure 2). A strategy was classified as *emergent* strategy when the two dummies did not match. This includes two sub-cases:

a) *scope-reducing strategy,* which occurs when a non competence-creating strategy is realized despite of competence-creating motives (bottom-left cell in Figure 2), and
b) *scope-enhancing strategy,* which occurs when a competence-creating strategy is realized despite of non competence-creating motives (top-right cell in Figure 2).

Finally, to measure divergence between motives and realized strategy, we define our dependent variable so that different kinds of *emergent* behavior are compared with *deliberate* strategy. In particular, EMERGENT STRATEGY equals 0 for deliberate (scope-fitting) subsidiary strategy, 1 for emergent scope-reducing subsidiary strategy and 2 for emergent scope-enhancing subsidiary strategy.

**Independent variables.** The independent variables are related to strategic and institutional factors. Strategic factors are considered at both the subsidiary and MNE group-level in line with IB research documenting the influence of both these factors on subsidiary's strategy (Birkinshaw and Hood 1998). In particular, we define the subsidiary local market orientation as the percentage of firms selling of goods and services in the host market. At MNE group-level, we used a dummy variable to indicate whether parent's operations are focused on one main line of business (Cantwell and Mudambi 2005).

In recent studies on emerging economies, institutional variables have been mainly measured by publically available indexes (Bevan *et al.*, 2004, Meyer *et al*. 2008). We opted to rely on perceptual measures to model how foreign investors perceive the host institutional framework. We consider institutional factors in static and dynamic terms to compile with the idea of organizational strategies as patterns of resource allocations that are inherently involved with change (Mintzberg and Waters, 1985). We measure the extent of institutional obstacles directly by asking respondents whether the tax assessment and payment procedures cause substantial costs and/or delays. Responses were reported on a five-point Likert scale, the Cronbach's alpha for the aggregate index is 0.71. The extent of institutional changes was measured directly by asking respondents whether the tax assessment and payment procedures cause fewer costs and/or delays now than when the foreign investment was first established. Responses were again reported on a five-point Likert scale, the Cronbach's alpha for the aggregate index is 0.89.

**Control variables**. A number of location and firm variables were included in the model to control for home and host country, MNE group- and subsidiary-specific characteristics. Differences in host country contexts were accounted for by the location of the subsidiary through two dummy variables for Poland and Lithuania, with Hungary serving as base case. In addition, to control for differences in the investors' home contexts with two dummies for firms originating respectively in North America or Asia, with European parent firms serving as base case.

At firm level, we control for both parent and subsidiary characteristics. Parent characteristics include: commercial experience in the host country and degree of decentralization. Since it has been argued that firms can develop their dynamic capabilities and thus coherently designing their strategy by learning from repeated practices (Eisenhardt and Martin 2000), we include a dummy variable to indicate whether the parent had prior commercial experience in the host country. We also control for the degree of local responsiveness to account for the variation of organizational strategies on the global stage (Barlett and Ghoshal 1989, Harzing 2000) using a two item measure capturing to what extend decisions are made locally rather than centrally.

As far as subsidiary-specific characteristics are concerned, we control for entry mode in the host market, industry context and subsidiary size. We account for entry mode by including a dummy variable for greenfield investments, which are expected to facilitate the accumulation of knowledge by providing opportunities to replicate home organizational structures and processes (Hennart and Park 1993). Extant literature has recognized that industrial sectors differ both in physical characteristics and in methods of production and delivery (Li 1994, Edgett and Parkinson 1993, Nicoulaud 1989). This implies that service and manufacturing firms may respond differently to comparable risk levels when entering a new market (Brouthers *et al*. 2000, 2002, 2003). Manufacturing FDI require greater investments in plant, equipment and inventory with relatively low investments in people. Therefore, manufacturing firms are recognized to be more sensitive to environmental uncertainties, while, because of the people-intensive nature of services, service firms are influenced by behavioral uncertainties (Brouthers *et al*. 2003). To account for these differences, we include a dummy variable indicating whether the subsidiary operated in a manufacturing industry. Subsidiary size effects were including in the model as measured by the log of the number of employees in the subsidiary.

We also include a respondent control for the possibility that the respondent personal characteristics may have influenced his or her perception of the dependent variable. Reassuringly, this control, expatriate manager, is not significant suggesting that no respondent bias is present in the data. The description of the variables included in the model is reported in Table A1.

A common concern in questionnaire based studies is common method variance, notably when perceptional measures are used (Podskoff et al. 2003, Eden et al 2008). We have adopted several measures to eliminate the impact of common method variance. Firstly, the questionnaire was distributed providing assurances of confidentiality to ensure unbiased responses. Second, the questions relating to dependent and independent variables were in different parts of the questionnaire. Third, we have transformed the original Likert-scale measures into dummy variables that, in the case of the dependent variable, underwent further transformations. Due to these measures, we are confident that no common method bias would inhibit the validity of our findings.

INSERT TABLE A1

## 5. Results

Descriptive statistics and correlation matrix of all variables are reported in Table 1. We model divergences between initial entry motives and realized subsidiary strategy by means of a multinomial logit analysis. Table 2 reports the estimations results for corporate emergent behavior distinguishing between scope-reducing and scope-enhancing subsidiary strategy.

INSERT TABALE 1 AND 2

We found that subsidiary local market orientation is statistically negatively significant as far as emergent scope-reducing strategy is concerned. In other words, subsidiary local market orientation lowers the likelihood of emerging scope-reducing (as compared to a scope-fitting) subsidiary strategy. By supporting H1a, this finding suggests that young foreign subsidiaries selling their goods and services mainly in the host economy can learn and adapt to the local market and consequently coherently realized original investment motives. The findings provide no empirical support to H1b. Instead, our results provide evidence to the argument that corporate operations focused on one main lines of business (as opposite to be diversified) lower the likelihood of emergent scope-enhancing (as compared to scope-fitting) subsidiary strategy, as argued in H2. Focused operations inhibit the accumulation of resources and capabilities in related fields which may help the MNE to identify opportunities in foreign markets. However, the variable measuring the parent's focus on one main line of business is only marginally significant.

Moreover, we found that institutional obstacles are statistically negatively significant as far as emergent scope-reducing strategy is concerned. The greater the extent of institutional obstacles in the host market, the lower the likelihood of an emergent scope reduction (as opposite to a scope fit) in subsidiary strategy. This result supports H3a and points out that institutional obstacles force firms to acquire information on the host market to reduce environmental uncertainty, while H3b is not tested. Finally, we also find empirical supports for H4a as shown by the highly statistically positively significance of institutional improvements as far as emergent scope-reducing strategy is concerned. The effects of transaction costs considerations are likelier to prevail over the benefits related to the institutional improvements of the business environment by making it unpredictable and unstable. In these conditions, emergent strategies are likelier to be emergent scope-reducing. The econometric exercise yielded no statistically significant results for emergent scope-enhancing strategy. Thus, H4b is not supported.

We obtained marginally statistically significant results also for two controls: manufacturing and greenfield. In particular, manufacturing firms are less likelier to show an emergent scope-reducing (as opposite to scope-fitting) strategy than service firms do. This is in line with the argument that in emerging economies where FDI penetration is a relative new phenomenon and the characteristics of the local resources are little know, the host environment may be easier to evaluate than human resources, for which the intangibility element is more relevant (Brouthers *et al*. 2002). As expected greenfield investments enhance the likelihood of emergent scope-enhancing strategy since they facilitate the accumulation of knowledge through the replication of home organizational structures and processes (Hennart and Park 1993).

## 6. Discussion and conclusions

We have integrated the emergent strategy perspective with Johanson and Vahlne's IP tradition. The proposed conceptual framework enables us to analyze a research question at the interface between IB and strategy research (Melin 1992), namely the reason for MNEs to modify their objectives while establishing subsidiaries abroad. Specifically, we explore the influences of corporate and institutional factors on emergent strategies (i.e. divergences between firm's initial entry motives and realized subsidiary strategy).

Our results indicate that resources and institutional factors have different influences on young subsidiary's emergent strategies which may evolve toward a scope reduction or a scope enhancement. In particular, change in MNEs internationalization process is influenced, to different extents, by subsidiary- and MNE group-level strategies as well as by static and dynamic characteristics of the local institutional framework. Institutional factors and subsidiary-level strategies strongly influence emergent scope-reducing strategies, while MNEs group-level strategies act on emergent scope-enhancing strategies.

The study makes three theoretically contributions. First, we contribute to the Johanson and Vahlne IP tradition by enhancing the explanatory power of the model. In particular, we solve two shortcomings of the model: the conceptualization of internationalization as a unidirectional process of gradually deepening commitment and the lack of a strategic dimension. The integration of the emergent strategy perspective in the IP tradition allows to generalize the internationalization process to multiple progressions (Van de Ven 1992) since more than one feasible path may be pursued in each respective stage, as in the strategic decision process study of Mitzberg *et al*. (1976). By integrating the emergent strategy perspective, we are also able to account for the role of purposeful strategic intent in strategic development process (Hamel and Prahalad 1989), in that firms may consciously modify the goals initially set.

Secondly, our analysis contributes to the literature on business in emerging economies, where calls for more integration between institution-based and resource-based perspectives have been recently made (Peng 2001, Meyer and Peng 2005, Wright *et al*. 2005, Yamakawa et al. 2008). This study provides strong evidence for the suggested complementarity of the resource and institutional perspectives in explaining firm's behavior in CEE contexts.

Thirdly, we offer a more general contribution to IB research. A lively debate has recently concerned the future of IB research agenda (Buckley 2002, Peng 2004) and a major outcome of such a debate has been the recognition of overlapping themes between IB and management research and of potential for mutual cross-fertilization between the two fields. The integration of the emergent strategy perspective in the IP tradition may be advocated as one of many examples where cross-field interaction propels IB research agenda.

Furthermore, our results enable us to address two criticisms moved to the IP model, namely the lack of consideration of the market and economic environment and the limited application of organizational learning (Andersen 1993, Forsgren, 1992). The predetermined nature of the internationalization process in the IP model rules out the possibility of unexpected consequences of unforeseen environmental interactions. By contrast, the integration of the emergent strategy perspective in the model implicitly involves the analysis of the factors influencing strategy-making such as the institutional framework of the market for which we found strong support in our analysis. Likewise, the analysis of corporate business factors influencing strategy-making enable us to consider alternatives to the concept of organizational learning merely conceived as learning through experience (Forsgren 1992). In our framework, organizational learning is also conceived as learning through mimetic behavior since greater domestic market orientation may also be regarded as a way to learn from customers and competitors.

***Limitation and future research***

Like any empirical study, our empirical investigation has a number of limitations. First, the use of a single data-collection method may bias our measures which are all derived from questionnaires. However, this approach allows us to obtain firm level data on the exposure to institutional obstacles that would not be available from indices from archival sources.

Second, our analysis focuses on the *change* aspects of the IP model. This limits the possibility of a comprehensive revision of the model by our study. However, it should be pointed out that extant research has mainly dealt with the *state* aspects and consequently an analysis on *change* aspects was lacking, as far as our knowledge is concerned.

Third, our dataset is cross-sectional and this reduces the scope of our analysis due to our interest in the *change* aspects of the IP model. Although our data allow capturing changes in strategic intent over time, this prevent us from observing the evolution of the internationalization process. Therefore, it would be interesting to investigate such evolution in a longitudinal study, which would involve multiple observations of subsidiaries over a period of time.

Future research may extend our conceptual model to investigate related research questions. For example, scholars may investigate the time lags involved in subsidiaries adapting to changes in their environment: Do scope enhancement and scope reduction occur with different time lags? Perhaps scope enhancements occur only after major changes and with longer time lags, which would explain the relative weak evidence that we find with respect to scope enhancement. Moreover, theoretical work may investigate the actual decision making processes within the pertinent top management teams that lead to changes of subsidiary strategy: Are decision makers facing cognitive barriers that would slow down adjustments to changing contexts?

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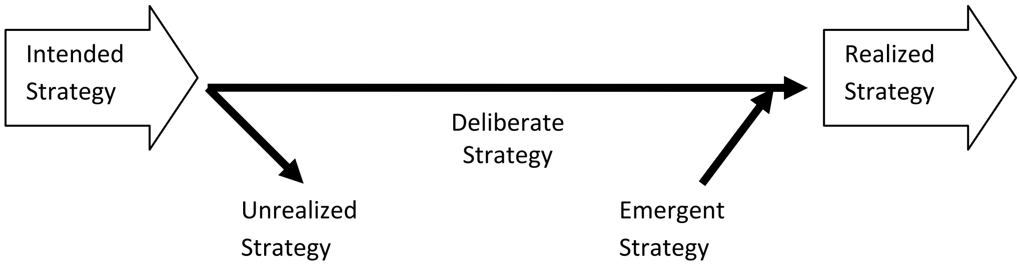
**Figure 1: Types of strategies**




*Source*: Mintzberg and Waters 1985, 258.

**Figure 2: Entry motives and realized subsidiary strategy**

| | | COMPETENCE-CREATING ENTRY MOTIVES | |
|---|---|---|---|
| | | *Yes* | *No* |
| COMPETENCE-CREATING REALIZED STRATEGY | *Yes* | Deliberate strategy (scope fit) | ***Emergent strategy (scope enhancement)*** |
| | *No* | ***Emergent strategy (scope reduction)*** | Deliberate strategy (scope fit) |

**Figure 3: Emergent strategies in the internationalization process**

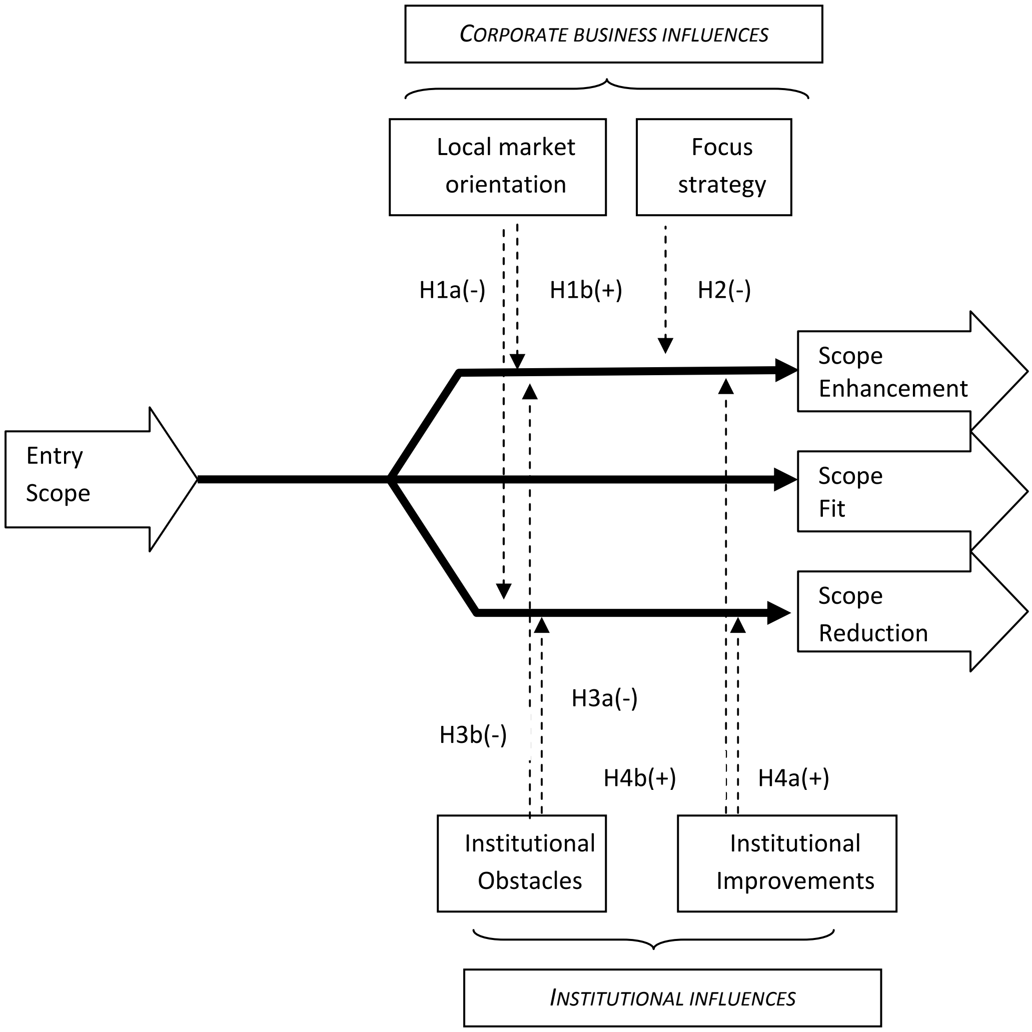


**Table 1 - Descriptive statistics and correlation matrix**

| | | Mean | Std. Dev. | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 | 11 | 12 | 13 | 14 | 15 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 1 | Local market orientation | 73.120 | 39.399 | 1 | | | | | | | | | | | | | | |
| 2 | Focused | 0.643 | 0.480 | -0.083 | 1 | | | | | | | | | | | | | |
| 3 | Institutional obstacles | 3.219 | 0.835 | -0.053 | 0.015 | 1 | | | | | | | | | | | | |
| 4 | Institutional improvements | 2.683 | 0.953 | -0.077 | -0.028 | -0.099 | 1 | | | | | | | | | | | |
| 5 | Poland | 0.374 | 0.484 | 0.095 | 0.115 | 0.193 | -0.205 | 1 | | | | | | | | | | |
| 6 | Lithuania | 0.174 | 0.380 | -0.088 | -0.003 | 0.000 | 0.041 | -0.312 | 1 | | | | | | | | | |
| 7 | Hungary | 0.452 | 0.498 | -0.027 | -0.107 | -0.184 | 0.166 | -0.731 | -0.420 | 1 | | | | | | | | |
| 8 | North America | 0.138 | 0.345 | -0.112 | -0.181 | 0.010 | 0.028 | 0.182 | -0.1029 | -0.100 | 1 | | | | | | | |
| 9 | Asia/other | 0.043 | 0.203 | -0.003 | -0.071 | -0.090 | -0.003 | 0.022 | -0.093 | 0.046 | -0.080 | 1 | | | | | | |
| 10 | Commercial experience | 0.437 | 0.497 | 0.058 | -0.072 | 0.126 | -0.031 | 0.133 | -0.240 | 0.045 | 0.000 | 0.061 | 1 | | | | | |
| 11 | Local responsiveness | 0.610 | 0.488 | 0.219 | -0.026 | -0.024 | 0.016 | -0.106 | 0.065 | 0.055 | -0.127 | -0.121 | -0.112 | 1 | | | | |
| 12 | Greenfield | 0.433 | 0.496 | -0.060 | -0.008 | 0.012 | -0.072 | 0.064 | -0.122 | 0.026 | 0.143 | 0.108 | 0.034 | -0.102 | 1 | | | |
| 13 | Manufacturing | 0.352 | 0.478 | -0.385 | 0.074 | 0.084 | 0.057 | 0.030 | -0.050 | 0.007 | -0.033 | 0.071 | 0.097 | -0.180 | -0.170 | 1 | | |
| 14 | Subsidiary size | 4.285 | 1.608 | -0.023 | -0.059 | -0.049 | 0.048 | 0.232 | -0.017 | -0.209 | 0.114 | 0.103 | 0.022 | 0.019 | -0.300 | 0.330 | 1 | |
| 15 | Expatriate manager respondent | 1.853 | 0.3547 | -0.01 | 0.008 | -0.1 | -0.01 | -0.18 | 0.1415 | 0.068 | -0.02 | -0.04 | -0.14 | 0.0477 | -0.0074 | -0.01 | -0.08 | 1 |

**Table 2 - Multinomial regression estimations§**

| | Emergent scope-reducing strategy | | | | Emergent scope-enhancing strategy | | | |
|---|---|---|---|---|---|---|---|---|
| | Coef. | Robust Std. Err. | Z | | Coef. | Robust Std. Err. | z | |
| Local market orientation | -0.011 | 0.005 | -2.340 | ** | 0.002 | 0.004 | 0.400 | |
| Focused | 0.355 | 0.382 | 0.930 | | -0.587 | 0.302 | -1.940 | † |
| Institutional obstacles | -0.483 | 0.225 | -2.150 | ** | 0.010 | 0.165 | 0.060 | |
| Institutional improvements | 0.561 | 0.177 | 3.170 | *** | -0.124 | 0.153 | -0.810 | |
| *Controls* | | | | | | | | |
| Poland | 0.477 | 0.491 | 0.970 | | 0.462 | 0.338 | 1.370 | |
| Lithuania | 0.536 | 0.540 | 0.990 | | 0.620 | 0.429 | 1.440 | |
| North America | 0.685 | 0.619 | 1.110 | | 0.351 | 0.463 | 0.760 | |
| Asia/other | 0.296 | 0.842 | 0.350 | | -1.300 | 1.114 | -1.170 | |
| Commercial experience | 0.418 | 0.390 | 1.070 | | 0.086 | 0.307 | 0.280 | |
| Local responsiveness | -0.203 | 0.391 | -0.520 | | -0.023 | 0.295 | -0.080 | |
| Greenfield | -0.552 | 0.385 | -1.440 | | -0.539 | 0.297 | -1.820 | † |
| Manufacturing | -0.782 | 0.433 | -1.810 | † | -0.153 | 0.355 | -0.430 | |
| Subsidiary size | -0.125 | 0.141 | -0.890 | | -0.002 | 0.103 | -0.020 | |
| Expatriate manager respondent | -0.411 | 0.396 | -1.040 | | -0.370 | 0.296 | -1.250 | |
| N. obs. | 329 | | | | | | | |
| Wald chi2(28) | 159.86 | *** | | | | | | |
| Log pseudolikelihood | -258.8767 | | | | | | | |
| Pseudo R2 | 0.284 | | | | | | | |

§Deliberate strategy (i.e. scope-fitting strategy) is the baseline category.
*** p< 0.01; ** p<0.05; †p<0.1.

**Table A1 – Variables definition**

| *Variables* | *Description* |
|---|---|
| ***Dependent variable*** | |
| Emergent strategy | 0 if subsidiary strategy was scope-fitting, 1 if subsidiary emergent strategy was scope-reducing, 2 if subsidiary emergent strategy was scope-enhancing. |
| ***Independent variables*** | |
| *Strategy variables* | |
| Local market orientation | Percentage of firms selling of goods and services in the local market. |
| Focused | 1 if parent's operations were focused on one main line of business; 0 otherwise. |
| *Institutional variables* | |
| Institutional obstacles | The extent to which institutional obstacles cause costs or delays, based on 5 items with 5-point Likert scales; $\alpha$ = 0.71. |
| Institutional improvements | The extent to which institutional obstacles have been reduced since the subsidiary was first established, based on 3 items with 5-point Likert scales; $\alpha$ = 0.89. |
| ***Controls*** | |
| *Host* | |
| Poland | 1 if the recipient countries was Poland; 0 otherwise. |
| Lithuania | 1 if the recipient countries was Lithuania; 0 otherwise. |
| *Home* | |
| North America | 1 if parent firm HQ was in North America; 0 otherwise. |
| Asia/other | 1 if parent firm HQ was in Asia or another non-European region; 0 otherwise. |
| *MNE group* | |
| Commercial experience | 1 if the parent had prior commercial experience in the host country; 0 otherwise. |
| Local responsiveness | The extent to which decisions are taken locally, based on 2 items with 5 point Likert scale. |
| *Subsidiary* | |
| Greenfield | 1 if the subsidiary was established through a greenfield investment; 0 otherwise. |
| Manufacturing | 1 if the subsidiary operated in a manufacturing industry; 0 otherwise. |
| Subsidiary size | Logarithm value of the number of employees in the subsidiary. |
| *Other controls* | |
| Expatriate manager respondent | 1 if the questionnaire respondent was an expatriate manager; 0 otherwise. |

[i] Mintzberg and Waters (1985) actually identify three conditions for emergent strategies to take place: 1) precise intentions hardly exist in the organization, 2) intentions are hardly common to virtually all the actors and 3) the environment is hardly perfectly predictable. Although we recognized equal relevance to each of the them, in this study we focused on condition 1) and 3), leaving aside intra-firm conflicts.

[ii] It is worth noting that organizational learning is not the cumulative results of their members' learning (Fiol and Lyles 1985).

[iii] We thank the research team who created the dataset for permission to use this dataset, and for assistance in interpreting it.