Internationalization: Does politics matter?

1. INTRODUCTION

Despite transnational institutions' efforts toward a more integrated world economy, governments' power to change the environment in which multinational corporations operate continues to make internationalization full of unpredictability and uncertainty. Legitimate instruments such as asset nationalization or tariffs enable national governments to drastically alter the bases underpinning global managers' foreign operation decisions. As a consequence, wise and profitable choices may turn into disastrous and detrimental ones. This challenge of aligning resource allocation with external uncertainties has long been discussed by researchers – from the first neoclassical institutionalist economic insights (Coase, 1937; Commons, 1931), through subsequent international explorations (Hymer, 1960/76), to the new institutionalist economics (Henisz and Williamson, 1999) – yet without any concise explanation of the implications government and multinational interplay may have on the internationalization process.

Internationalization can be held in various governance modes, from the purely contractual, as with exports or licensing (Reid, 1981; Hedlund and Kverneland, 1985; Katsikeas, Leonidou and Samiee, 2008), through hybrid modes such as joint ventures and alliances (Contractor and Lorange, 1988b, 2002; Kogut and Singh, 1988; Henisz, 2000b; Yamin and Golesorkhi, 2010), to outright ownership when foreign direct investment (FDI) is involved (Brouthers and Brouthers, 2000; Blonigen, 2005; Delios and Beamish, 2001). These modes are widely recognized among strategic, economic and institutional international field theories; however, there is no consensus on the governance modes' purpose. For instance, new institutionalist theorists look upon the various governance modes as a consequence of the host countries' institutional environment (Boddewyn, 1988; Boddewyn and Brewer, 1994; Scott, 1995, 2005). The institutional environment defines the governance mode, as it contributes to a poor or friendly investment climate. Whereas high-quality institutional environments attract investment through ownership modes, low quality ones normally deter ownership under contractual modes. In another vein, new institutionalist economics (Williamson, 1985; Henisz and Williamson, 1999) discusses whether governance modes can include safeguards against transactional hazards or must themselves be safeguarded from host environment hazards. While ownership modes can protect against transactional hazards, assets owned abroad become exposed to expropriation. Hence, Henisz and Williamson (1999) suggested that contractual and ownership modes must be balanced, taking into account not only internal uncertainty, but also the external uncertainty that arises from the host country. Additionally, strategic field institutional studies (Doz and Prahalad, 1984; Hitt, Keats, and DeMarie, 1998; Hitt, Franklin and Zhu, 2006; Peng, 2003; Shenkar, 2001; Shenkar, Luo and Yeheskel, 2008) claim that the decision on the mode of governance of foreign operations depends not only on the quality of the host government but rather on the 'distance' between home and host country's institutional environments. These studies understate that

the closer the host country, the easier it is to deploy home country knowledge; therefore, ownership modes should occur more frequently than in more distant countries.

From the above overview, strategic studies may look more complete to the extent that differences between countries are included, though they fall short in explaining governance preferences, using only the lenses of knowledge while setting aside the external uncertainty implications. In turn, economics-based theories emphasize uncertainty and explain ownership modes through the firm's aim to control uncertainty, yet still with the absence of a strategic fit between home and host country. As if that were not enough, neo-political economics (Henisz, 2000b; Henisz and Delios, 2004; Henisz and Zelner, 2006; Simonis, 2001) further complicates this apparent mismatch between strategic and economic-based studies. Through the example of government transactions, they point to economics studies' insufficiency in explaining transactions that are not susceptible to internalization and control, and, interestingly, propose a strategic fit based on home and host country differences in circumventing the lack of political environment control. From these conceptual mismatches and shortfalls a natural question arises: Does politics matter in internationalization?

The question is pertinent since it reassesses the first insights on firms' internationalization rationales (Hymer, 1960/76). It addresses Hymer's fundamental dilemma between contractual and ownership modes to justify why firms prefer the latter rather than to just maximize contractual rents. Furthermore, in addition to the implications of the specific strategic advantages, the discussion also draws on Hymer's structural view (Yamin, 1991) of internationalization drivers by including the implications of the institutional environment on the control of foreign operations. Other control conceptualizations such as those limited to strategic entry mode options (Pan and Tse, 2000), corporate strategy (Gatignon and Anderson, 1988), or structural equity (Casson, 1987) at the firm level are not discussed here.

Accordingly, a macro-level framework is proposed in order to explain how contractual and ownership modes are influenced by the environment, specifically through the differences between home and host country environment. This paper's contribution is augmented by including the political links between (home and host) governments into the institutional difference analysis. As Henisz (2000b) recognized while demonstrating strategic governance alignment with transactional and political hazards, political ties may influence resource allocation abroad. This call for research was never answered despite the numerous studies that followed it (Delios and Henisz, 2003a, 2003b; Henisz and Delios, 2001, 2004; Henisz and Macher, 2004; Henisz and Zelner, 2003, 2004, 2005, 2006).

In the search for political ties between countries, the diplomatic missions emerged as the best proxy instrument of governments to represent and carry out national interests not only at political but also at economic levels (Naray, 2011). In this regard, primary data was collected on British, Dutch, and Swedish diplomatic networks of up to 91 different countries, resulting in a dataset of 243 diplomatic missions after listwise deletion. The empirical tests were undertaken in a Structural

Equation Model (SEM) accompanied with a path analysis to reveal the direct effects of the latent variable formative measures.

The results indicate legal and political differences' importance to the institutional environment. Relative to the role of the diplomatic network, a moderating effect was indeed detected that even eliminated the constraints of political differences between the home and host country. However, as important as this moderating effect, the diplomatic network variable was found to have strong direct effects on the intensity of both contractual and ownership modes. The diplomatic network variable's high statistical significance with the presence of large mass control variables, such as GDP, as well as its strong effect on the dependent variable's proxies by Exports and Foreign Direct Investment (FDI), reveals a robust predictive and explanatory power that should be present in future research on the internationalization phenomenon.

The following section of this paper contextualizes the research question within the extant literature while a set of four hypotheses is developed therefrom. Section 3 describes the research methodology. The analysis and results are presented in Section 4. Section 5 includes the discussion, limitations and conclusions.

2. THE INSTITUTIONAL ENVIRONMENT AND FOREIGN OPERATIONS

The institutional differences among countries, while sharper than within countries, are a fertile ground for evolving institutional economics studies (Scott, 2005). Institutional resilience reduces environmental uncertainty and structures economic interactions. Being more stable than organizations, institutions shape the environment wherein organizations interact and transactions are held. Therefore, institutional environment determines the, "transaction and production costs and hence the profitability and feasibility of engaging in economic activity" (North, 1991: 97). Claiming to be the first to include multinational parties in the implicit domestic focus on transaction costs, Henisz and Williamson (1999) extended Williamson's 1975 Transaction Costs Economics (TCE) into the international field by comparing different institutional environments within and among countries. In order to identify the hazards to which different foreign operation governance modes are subject, the political component was distinguished from the informal and formal institutional environment dimensions (North, 1990; Scott, 1995, 2005).

The discretionary power that political institutions – namely governments – have toward the environment justifies their detachment from the formal elements. To the extent that governments can reverse the law, or judicial decisions, or just favor certain firms while discriminating against others, economic resource allocation logic may become distorted (Henisz and Williamson, 1999; Zhou and Poppo, 2010; Zhou, Poppo and Yang, 2008). Once transactions are conducted at both the formal and the informal levels of the institutional environment (Henisz and Williamson, 1999), formal rules – constitutions, laws, and property rights – in addition to informal constraints such as norms, customs, mores, and religion, all compete to structure the institutional environment. Idiosyncratic political

legitimacy detaches itself from formal and informal levels and even from subordinated powers, such as public institutions (Hadjikhani and Ghauri, 2001, 2006; Henisz, 2009; Westney, 1993; Zucker, 1983) or social organizations (Bengtsson, Hadjikhani and Pahlberg, 2009; Hadjikhani, Lee, and Ghauri, 2008).

In this sense, institutions' contribution toward a poor or friendly investment climate becomes a crucial determinant in a multinational's FDI decisions (Blonigen, 2005; Frankel and Rose, 2002; Globerman and Shapiro, 2003). In addition, a wide array of empirical international field studies have detected a positive relationship between institutional environment and equity investment degree, including the decisions between portfolio and direct investment (Ahlquist, 2006), political hazards' influence on equity governance (Henisz and Delios, 2003; Henisz and Macher, 2004), regulated industry firms' FDI location choices (Garcia-Canal and Guillen, 2008; Henisz, 2003), or the small- and medium-enterprise entry mode (Maekelburger, Schwens and Kabst, 2012).

The conceptual rationale of Henisz and Williamson (1999) has empirical validation. Assessing how contractual and political hazards each may influence foreign operation equity degree, Henisz (2000b) found that foreign investors prefer to control their operations through higher ownership modes when threatened by opportunistic local partner behavior. To the extent that political institutions in low-quality environments are more vulnerable to manipulation (Henisz, 2000b; Henisz and Zelner, 2004), opportunistic behavior is amplified and more detrimental to the foreign investor when the political environment is weaker.

Despite the evidence, Henisz (2000b) recognizes that resource allocation based exclusively on formal, informal, and political differences among different institutional environments falls short in the explaining the degree of foreign investment ownership. Referring to Nigh's (1985) work on the effect of political events on FDI, Henisz suggested political links' importance over institutional differences to speculate that, "the strength of political ties between host country and home country governments may influence the magnitude or even direction of this effect [on the degree of ownership in foreign investment]" (2000b: 339). Though, Nigh's results[1] did not fully answer Henisz's thoughts. Indeed, more significant than looking at disruptive political events' direct investment causal effects is the search for the stronger and more resilient effects of political ties amid governments. That is, departing from Henisz and Williamson's (1999) conceptual model, stable political ties between governments may hinder the distance effect vis-à-vis ownership degree. In other words, formal, informal, and political similarities or dissimilarities may not be sufficient predictors of the internationalization's governance mode.

In this regard, the conceptual model proposes the diplomatic network as a stable political link between home and host countries. To align with Henisz and Williamson's (1999) distinguishing of the

[1]With support on a longitudinal data set of 21 years of outward FDI from United States, Nigh (1985) found that FDI intensity increased or decreased with the cooperation or conflict events between home and host country, respectively.

institutional environment's political dimension, this model tightens Boddewyn's (1988) non-business definition of political elements, ascribing them to the governments and related power branches (Henisz, 2000a). The negative contribution to foreign operations ownership that is brought about by the dissimilarities with host countries' political environment (Henizs, 2000b) can be moderated through the active role of home countries' governmental institutions abroad, such as the diplomatic missions. Therefore, by incorporating informal, formal, and political elements in the analysis of governance modes, the model extends previous studies that selectively tapped the environment components in formal and informal (Zhou, Poppo and Yang, 2008; Zhou and Poppo, 2010), formal and political (Henisz, 2003; Henisz and Macher, 2004; Henisz and Zelner, 2003, 2004, 2005, 2006; Henisz and Williamson, 1999) or informal and political (Delios and Henisz, 2003a, 2003b; Henisz and Delios, 2001, 2004; Hitt et al, 2006).

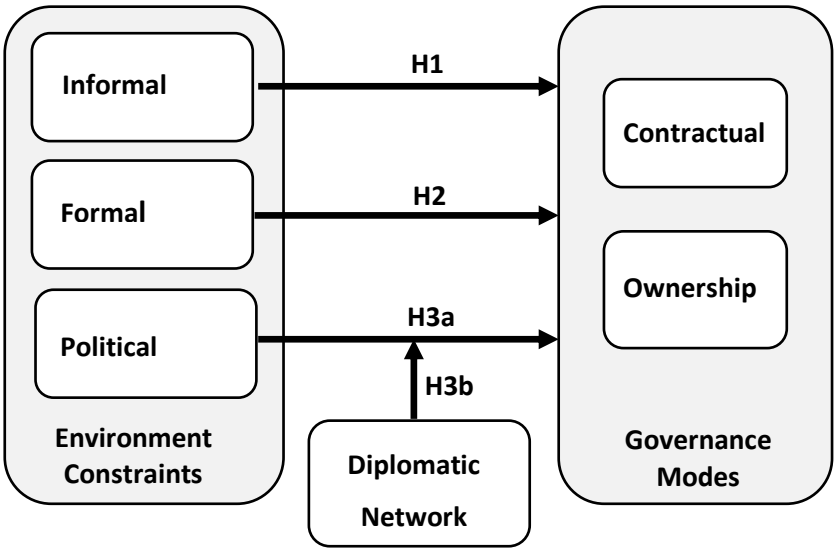


Figure 1. Conceptual Model

The informal dimension of the environment

Misunderstandings of national culture and local discrimination are hazards that frequently arise in informal institutional environments. Culture, as a construction of shared values, divides insiders from outsiders. Norms, customs, language, or religion are part of cultural heritage, of which cognitive and normative features are the most difficult to comprehend by outsiders (Scott, 1995, 2005). The liability of being foreign is experienced in governments' and host country clients' discriminatory attitudes toward multinationals' subsidiaries (Hymer, 1960/76; Zaheer, 1995; Zaheer and Mosakowski, 1997). The legitimacy gap perceived by host country institutions places multinationals at a disadvantage (Hadjikhani, Lee, and Ghauri, 2008). Furthermore, nation-culture subjectivity, at once difficult to be both expressed by one party and interpreted by the other, causes communication ambiguity. The

likelihood of adverse behavior and resistant conduct from local structures increases international operation integration costs (Doz and Prahalad, 1984), as well as the failure rate (Barkema and Drogendijk, 2007).

The analytical view of nation-culture through quantitative profiles (Hofsteed, 1980; Schwartz, 1994; House, Hanges, Javidan, Dorfman, and Gupta, 2004; Dow and Karunatna; 2006) informs the notion of cultural distance between countries by providing tools to operationalize its consequences. The negative relation between the multinationals' performance and cultural distance is suggested by several empirical studies (Doz and Prahalad, 1984; Shenkar, 2001; Shenkar et al 2008; Barkema and Drogendjik, 2007). Multinational firms' organizational cultures are shaped by the values and beliefs of the origin country (Doz, Santos and Williamson, 2001). Activities in different cultural settings compel adaptation that diminishes the economies of scale (Dunning, 1988). More distant cultures require increased acculturation, driving multinationals to make smaller investments (Barkema and Drogendjick, 2007).

Therefore, because similarities are easier to manage than dissimilarities (Erramilli, 1991), closer cultures do not demand deep alterations to functions, processes, and products and the risk of change is reduced. Furthermore, the overarching feature of normative elements, such as education or industrial structures, endow national cultures with wider values (Easterlin, 1981; Kaufmann et al, 2010), bringing cultures closer and reducing the legitimacy gap (Makino and Tsang, 2011). Therefore, cultural distance as a source of hazard in the informal institutional environment will negatively affect international activity governance, whether through contractual or ownership modes.

However, cultural distance per se is not a problem unless interactions are undertaken between individuals from different cultures. Oded Shenkar's metaphor of friction explains the effect of cultural distances with the type of interaction (see also Shenkar, Luo and Yeheskel, 2008). Friction, as he defines it, is, "the scale and essence of the interface between interacting cultures, and the 'drag' produced by that interface for the operation of those systems." (Shenkar, 2001: 528).

In this rationale, ownership modes, as they demand more contact with locals than contractual modes, are more prone to friction and, consequently, to efficiency losses. For instance, sales offices and manufacturing plants have more contact with locals and, consequently, have more friction than a mere sales representation office. Given that the cultural dissimilarity hazards are amplified not only by distance, but also by the interaction degree, informal institutional dissimilarities between countries may have a bigger effect on ownership modes than on contractual modes and, thus, the hypothesis formulation:

> H1: Dissimilarities of informal institutional environments have a stronger negative effect on ownership than contractual modes of governance

The formal dimension of the environment

As opposed to the informal level's cognitive and normative elements, the institutional environment's formal level includes regulatory elements, such as constitutions, laws, property rights and regulations (Scott, 1995; La Porta et al, 2008). The formal environment's characterization by well-defined property rights, well-conceived laws and courts that enforce those laws in their principles, reveals an implicit order thereof. Rules and regulations establish conduct (North, 1990). The more secure the property rights and regulations, the less the likelihood of either opportunistic behavior or contractual hardness (Williamson 1975, 1985). As further argued by Henisz and Williamson (1999), once courts are a last step for solving conflicts, any disagreement can be solved either within the hierarchy or the market if no major conflicts or disputes arise.

However, if conflicts are irreconcilable, litigation is unavoidable and raises the demand for well-conceived laws and judiciary enforcement. As secure property rights and clear regulations are necessary but not sufficient, economic efficiency only endures if contracts designed under those property rights and regulations are effectively enforced by law and courts (Henisz, 2000a; Kaufmann et al, 2010). Whereas formal hazards arise from weak institutions, effective safeguards adhere in strong institutional environments. Formal hazards such as creeping expropriation (Sawant, 2010) or debt repudiation (Schnitzer, 2002) are prevented mainly by the effective enforcement, irrespective of ownership or contractual governance modes (La Porta et al., 2008; Globerman and Shapiro, 2005). The formal environment becomes crucial for both contractual exchanges and investments. More secure property rights and regulatory regimes elicit more investment (in non-redeployable as well as less durable assets), whereas better legal enforcement fosters contracts (Henisz and Williamson, 1999; Henisz, 2000b).

Nonetheless, Henisz and Williamson (1999) only address the host environment in their paper. It may not be equally applied to ownership and contractual modes if the home country institutional environment is added to the analysis. Although the host country formal environment safeguards either domestic or foreign firms' operations, contractual modes, such as exports, may be more efficient if considering home and host country institutional environment similarity. The Coasian roots of Williamson's TCE help to build the logic. Coase (1992), referring to his previous works on transaction costs (1937), and the institutional structure of production (1960), explained that transaction internalization is subsidiary to market coordination. As efficiency is primarily a feature of the market, Coase (1960) advocated a world of zero transaction costs.[2] A worldwide legal system, he argued, could be the source of global efficiency competing with the economic order as, "it makes little sense for economists to discuss the process of exchange without specifying the institutional setting within

[2] It is important to notice that a world of zero transaction costs is not a world with zero coordination costs. Coase (1992) clarifies that scale decreases transaction costs; as a consequence, the world scale is the most efficient one.

which the trading takes place, since this affects the incentives to produce and the costs of transacting" (Coase, 1992: 718).

The similarities between institutional environments, namely their formal elements, approximates Coase's (1960) ideal of a common legal system wherein transaction costs decrease into residuals. In this regard, although the quality of the host institutional environment fosters both ownership and contractual governance modes, the similarity of the institutional environment between host and home country decreases transaction costs to such levels that contractual modes should prevail over ownership. Empirical evidence given by Helpman, Melitz and Yeaple (2004) substantiates this principle. Using exports and affiliate sales data in 38 countries, they depicted that the fewer the causes of trade frictions, the more exports relative to direct investment are used to serve foreign markets. The similarities between formal institutional environments ease trade contracting elaboration and enforcement. As a result, as well-defined contracts are more easily enforced, potential opportunistic local firm behavior decreases (Williamson, 1975). Ownership becomes of suppletory interest. Therefore, put in the context of dissimilarities between institutional environments, the more dissimilar the environment between home and host country, the higher the transaction costs and the less contractual modes are to be used; thus, the formulation:

> H2: Dissimilarities of formal institutional environments have a stronger negative effect on contractual than ownership modes of governance

Political Environment and Governmental Ties

A related legal concern is the problem of law reversal (Henisz and Williamson, 1999). While the formal environment is important to enforce the law, the political environment is fundamental to maintaining the principles of the law. Real-world business deals are long, complex processes, from their settlement to their realization. Therefore, the maintenance of the "rules of the game" is of paramount importance for firms to achieve their expected outcomes (North, 2005). Moreover, since firms' expectations are national economy outcomes at an aggregated level, the legal framework stability is important not only for firms but also for governments. Empirical evidence compiled by Henisz (2000a) showed this transitive relationship between political environment stability and national outcomes. Analyzing the structure of political branches, he finds that policy changes are negatively related with the heterogeneity of political structure. More independent branches with veto power and partisanship misalignment lead to policy stability and to higher national economy performance.

However, a different reality in what should be a "common endeavor" of firms and governments for stability is depicted by contrasting phenomena. Paradoxically, neither governments nor firms appear to want stability over change. In fact, even Henisz's (2000a) work suggests that policy change is a primary governmental concern that is only deterred when no partisanship alignment is attained between the national government and its lower branches of power. On the other hand, firms

do seek change or to efficiently cope with it. Through lobbying, firms pressure governments to make policy changes that approach their resources' actual configuration or, in case that change leads to resource redeployment, that promote its efficiency (Henisz and Zelner, 2003, 2004, 2005, 2006). Pinto and Pinto's (2008) longitudinal study on investment-type cycles with national government party changes substantiates this efficient resource redeployment rationale, demonstrating that firms adapt their investment types with party changes in government. They find that changes of political parties do not affect the investment level, but the emphasis of investment within more labor or capital-intensive orientation. Therefore, the problem seems not to be of stability over change, but of predictability of change.

In the scope of international business, firms' capacity to predict and cope with change is associated with political environment similarity between home and host country, and becomes the main safeguard against political hazards. Through comparing multinationals' operations in 80 heterogeneous institutional environments, Perkins (2008) found that foreign-owned unit survival rate depended more on home and host country institutional environment similarity than on the multinationals' previous experience. In the same line, Henisz and Delios (2004), analyzing 2,283 affiliates in 52 countries, concluded that the subsidiaries' exit rates within political regime changes were due to knowledge mismatch in dissimilar institutional environments. Hence, foreign operations' performance and survival may not depend on host country environmental stability but rather on firms' ability to cope with institutional environment changes.

Considering the above, the more dissimilar the multinational firm perceives the host political institutional environment to be, the higher the likelihood of decreasing foreign operation's ownership, and thus the hypothesis formulation:

> H3a: Dissimilarities between political institutional environments have a stronger negative effect on ownership than contractual modes of governance

However, institutional similarities may not be enough to safeguard foreign investments. Given that the public nature of state institutions and governments impedes firms fully internalizing transactions, political links between governments may be of major importance to protect those foreign operations governed by ownership modes. Unlike contractual hazards that can be controlled and mitigated by internalizing assets related to private transactions, direct and indirect political hazards are impossible to mitigate through internalization. The control endowed by ownership, although safeguarding against contractual hazards, cannot be defend against political hazards (Henisz and Williamson, 1999; Henisz, 2000b). Because governments have the asset expropriation monopoly, multinationals have to find other safeguards for their investments than through ownership. Moreover, the benefits of ownership for controlling private contractual hazards when local firms have privileged relations with local

politicians, may not compensate the potential risk of expropriation by host public entities (Henisz and Williamson, 1999).

The limitations of private entities to fully internalize government transactions and the resulting lack of political hazard control (Henisz and Zelner, 2004) compels multinationals to include international political links as safeguards not only in similar political environments, but even in adverse host environments (Henisz, 2000b). To the extent that legitimacy depends on external constituents' acceptance and approval (Kostova et al, 2008: p.1000), the relationships between governments and firms may have different legitimacy interpretations whether in domestic or foreign settings. Whereas governmental institutions have different audiences inside and across national borders, their relationships with firms might seem illegitimate or legitimate depending on the context.

The use of multinationals as political instruments to achieve political goals abroad or the consequences of either conflict or cooperation among governments in multinationals' foreign investment intensity are some examples given by Nigh (1985) to illustrate different legitimacy perspectives. Moreover, it is not only the achievement of national economic or political goals that may alter the viewpoint of legitimacy. Nationalism issues regarding natural resources (Click and Weiner, 2010) or host country governments' discriminatory behavior (Henisz 2000b, Bradley, 1977), besides giving a perception of legitimacy toward political pressures exerted abroad on home country governments to protect their firms, can even be seen as fundamental for national interest protection (Nigh, 1992).

Therefore, multinationals' perception of home and host country political ties, such as the diplomatic network, may be reflected in an increase of ownership modes; thus leading to the following hypothesis formulation:

> H3b: The negative effect that dissimilarities between political institutional environments have on ownership and contractual modes of foreign operations is diminished with the intensity of diplomatic presence

3. Empirical Material, Measures and Statistical Model

The evidence to test the hypotheses was gathered from primary and secondary sources. The sample size resulted from the constraints of primary data collection. The search for stable inter-government political ties included public sources on diplomatic networks, such as national budget reports or foreign affairs ministries' websites. Surprisingly, the information available on the diplomatic missions is scarce and held with some discretion. Reports on national budgets often do not separate the amount due to their diplomatic network abroad and its division by mission is completely absent.

As a result of this lack of publicly available information, an inquiry was sent directly to the 38 countries' Ministries of Foreign Affairs.[3] Anticipating some difficulties and response resistance, the inquiry was kept short and only three items were addressed to each country regarding their diplomatic missions on 37 countries: the date of establishment, the personnel affected, and annual expenses.[4] The first contact was undertaken through e-mail messages, later reinforced by post mail and phone calls in case of lack of reply. To motivate participation, the study's academic nature and confidentiality were highlighted in every direct contact.

Constraints related to national interest, state secrecy, national security, or just poor public services, led to few complete inquiries. African and Asian countries did not cooperate at all. From North America, Canada replied with partial data and the United States, although not refusing the data disclosure, estimated a delivery date between one and two years. From South America, only Brazil replied, and only with partial data. As for Oceania, while Australia took 10 months to send the data, New Zealand did not reply at all. European governments were more cooperative: Scandinavian countries as well as Austria and Switzerland replied in time and with complete data. The Netherlands and the United Kingdom were the most cooperative and accurate, replying in time and with structured data. Surprisingly, Germany did not answer at all. Not as surprisingly, France diverted with bureaucracy and did not reveal any sort of information. The remaining countries replied partially or declined to give the requested information.

Due to the mentioned difficulties, the study was reoriented toward the most cooperative countries and, instead of bilateral data on 38 countries, unilateral data was requested from Sweden, the United Kingdom, and The Netherlands regarding their entire diplomatic network. Despite all the contingencies, a dataset of 357 diplomatic missions in up to 91 different countries was obtained. Listwise deletion of observations with missing data and outlier removal formed a dataset of 243 total observations, which enabled analysis in structural equation modeling (Kline, 2010). Besides the diplomatic network variable, the information regarding other measures and controls was collected from either institutional databases (World Bank, UNCTAD, and OECD) or established country-level studies, such as Douglas Dow's research on 'psychic distance stimuli' and Witold Henisz's institutional studies on political constraints.

Measures for Dependent Variables

The degree of foreign operations is commonly associated with ownership intensity. A series of studies assesses this control gradation by comparing the sequential establishment modes (Anderson and Gatignon, 1986; Johanson and Widersheim-Paul, 1975; Leonidou and Katsikeas, 1996; Malhotra and Hinings, 2010), the equity participation in joint ventures and international alliances (Kogut and Singh,

[3] Selection supported in Dow and Karunaratna (2006) to allow a bilateral study and comparative analysis of results.

[4] This excludes the amounts of international aid and cooperation projects.

1988; Henisz 2000b), the cooperative and non-cooperative internationalization modes (Contractor and Lorange, 1988a, 1988b, 2002), or just ownership and contractual governance modes (Hymer, 1960/76; Erramilli, 1991; Erramili and Rao, 1993). The present study follows the latter vein.

Hence, using two dependent variables, internationalization's governance mode is measured through the variance between outward FDI and Exports intensities from one country to another. For country comparison consistency, the data was obtained from global databases that supplied bilateral data (Fieler, 2011). *FDI* information derived from the OECDstats dataset. From the two components available, FDI flows and positions (stocks), the latter was employed once it reflects the revaluation of foreign investment participations at market prices. A longitudinal series between 2000 and 2009 was extracted and the mean value calculated for cross-analysis. This procedure is similar to other cross-sectional studies with longitudinal data series (Dow and Karunaratna, 2006). The second dependent variable – *EXP* – was measured similarly to *FDI*, though with UNCTAD's data.

Measures for Independent variables

Informal Elements. We used Dow and Karunatna's (2006) four dimensions of 'psychic distance stimuli':[5] language, religion, education, and industry development to measure the differences of the informal environment between countries. Following Scott's (1995) and (2005) cognitive-cultural and normative elements of the informal institutional environment, language and religion were used to measure the former, while education and industry measured the latter element. The informal institutional environment is, henceforth, depicted through a composite index built with these four components. The use of a composite index rather than factor reduction is justified by the high correlation among Douglas Dow's 'psychic distance stimuli' dimensions. The methodology is the same employed by Kogut and Singh (1988) with Hofstede's (1980) cultural components, though with Douglas Dow's latest publicly available values:[6]

$$DK4 = \sum_{k=1}^{4} (I_{ijk})^2 / V_k / 4$$

wherein the variable I_{ijk} is the distance between countries i and j for the kth dimension of psychic distance, and V_k holds the variance of the kth dimension across 120 countries.

Several reasons support using Dow and Karunatna's dimensions. First, these dimensions are already tested in gravity models with Exports (Dow and Karunatna, 2006) and FDI (Dow and Ferencikova,

[5] Dow and Karunaratna's (2006) psychic stimuli includes "democracy" in addition to the four variables in use. The "democracy" variable concerns the country's political system and was excluded from this study because of colinearity with Henisz's (2000a) PolCon.

[6] http://www.mbs.edu/home/dow/research/, last accessed in 11 August 2012

2010) as dependent variables. Second, the results of both of those gravity models show these dimensions to be statistically more significant than other measures concerning the informal institutional environment (Hofstede, 1980; Kogut and Singh, 1988). Third, as opposed to other cultural difference indices (Hofstede, 1980; Schwartz, 1994; House, 2004), the dimensions are held on national attributes that intend to be 'stimuli' toward individual perceptions, rather than the individual perceptions themselves. This macro feature of Douglas Dow's dimensions anticipates eventual mismatches with this study's country-level analysis.

Formal Elements. The formal institutional environment elements are measured through two aggregate components of Kaufmann et al.'s (2010) Worldwide Governance Indicators (WGI). These indicators are part of the WB governance project and cover 200 countries in a longitudinal series from 1996 to 2010. The data sources are eclectic, ranging from non-governmental organizations to public sector organizations. The two components used, Regulatory Quality (*REG*) and Rule of Law (*LAW*), are intended to reflect not only the regulation quality, but also their respective enforcement by the courts and public authorities in general. In the original database offered by the World Bank Group, these variables were reported in estimates and percentile rank. The percentile ranks were preferred over estimates given their superior cross-country comparison accuracy. The distances between countries derived from their ranked positions in order to reflect countries' legal environment dissimilarities.

Political Elements. Following Henisz's (2000b) suggestion, political hazards and safeguards are measured through two different variables, respectively. The first is in line with the previous formal and informal measures and concerns institutional environment differences. At a political level, these differences are obtained by comparing Henisz's 2000 *PolCon* index between home and host countries, which allows a quantitative political hazard measure based on the political structure of the government's levels and branches with veto power. Despite *PolCon*'s original use to infer the quality of one country's institutional environment with national growth (2000a) or inward multinational investment (2000b), several studies apply it to measure cross-country political differences (Delios and Henisz, 2003a, 2003b; Dow and Karunaratna, 2006; Henisz and Delios, 2001, 2004; Henisz and Macher, 2004; Maekelburger *et al*, 2012). Following the same methodology, an average *PolCon* data score for a time series from 2000 to 2007 was calculated for each country. The algebraic difference between home and host country values indicates the respective political structures' distance and proxy the political hazards amplitude. As regards political safeguards, they are measured through the political links between countries, namely the home country's diplomatic presence in several host countries. This data consists of the primary data described previously and was limited to the number of personnel and expenses due to lack of certainty about the information regarding the establishment date each diplomatic mission. The intensity of each mission's diplomatic presence (*DiP*) was attained through factor reduction undertaken with principal component analysis including the natural personnel

(*PER*) and budget (*BUD*) indicator logarithms. The reliability tests of the resultant construct reported a Cronbach's alpha of 0.92.

Control variables. The geographical distance, gross domestic product (GDP), and time differences are argued as conventional variables to control for country-level fixed effects in gravity models (Blonigen, 2001, 2005). This study follows the recommendation and employs GDP and geographical distance given their commonality in predicting both international trade and FDI (Blonigen, 2001; Helpman et al, 2004). The time difference variable is excluded due to its single use to control FDI, which accounted also for parsimony reasons related to structural equations models (Kline, 2010). Geographical distance variable (*GEO*) data was collected from the CEPII database (Mayer and Zignago, 2011) and refers to the distance in kilometers between capital cities. Current GDP values in M$ as reported in UNCTAD's database for the last 10 years were extracted and their average calculated. Following conventional practices in gravity model (Blonigen, 2005), the mass effect between home and host country (*GDPji*) was set by the product of the two GDP values, though with the inverse value GDP of the home country given the unidirectional approach of the present study (see also Disdier and Head, 2008).

The Statistical Model

A structural model was adopted over the option of running two separate linear regressions models. Three main reasons support this choice. The first follows the hypothesis formulation. SEM is a proper model to use when the relations between the variables formulated in the hypotheses are supported on strong theoretical ground (Kline, 2010). The second concerns the relationship between the independent and dependent variables. More than to confirm some causal effect of the independent variables on the dependent variables, it is important to understand the relative strength of the independent variables' effect towards each of the dependent variables. Although the causality significance can be achieved through two regression models, only in SEM is it possible to know the relative intensity of the effect of an independent variable on two dependent variables (Kline, 2010). The third comprises the need to use two highly correlated variables in the same model. Unlike regression models, SEM allows the use of correlated variables with latent variables – in our case the *REG* and *LAW* attributes of the legal environment.

A general model is thus designed in a path analysis model with one latent variable measured by two formative variables. The use of formative rather than reflective variables is supported by several studies which define the formal environment as the conjunction of regulatory framework and judicial enforcement (Casson, 1987; North, 1990, 1991; Poppo and Zenger, 2002; Henisz and Williamson, 1999; Zhou and Poppo, 2010). The analytical formula of the econometric model fits our research question as follows:

$$Y = BY + X\Gamma + \alpha + \zeta \tag{1}$$

where Y represents the matrix of the variation of observed endogenous variables *FDI* and *EXP*. $B = [\beta_{ij}]$ represents the matrix of coefficients on endogenous variable *LEGAL* as a latent variable obtained with *REG* and *LAW*. $\Gamma = [\gamma_{ij}]$ is the matrix of coefficients of exogenous variables, *REG* and *LAW*, additionally are included *GEO*, *GDPji*, *DK4*, *PolCon* and *DiP*. The $\alpha = [\alpha_i]$ is the vector intercepts for the endogenous variables, and ζ is assumed to have a mean zero and $COV(X, \zeta) = 0$. Let $\kappa = [\kappa_{ij}] = E(X)$, $\Phi = [\phi_{ij}] = Var(X)$ and $\Psi = [\psi_{ij}] = Var(\zeta)$, then the mean vector of the endogenous variable is:

$$\mu_Y = E(Y) = (I - B)^{-1}(\Gamma\kappa + \alpha) \tag{2}$$

and the variance matrix of the endogenous variables is:

$$\Sigma YY = Var(Y) = (I - B)^{-1}(\Gamma\Phi\Gamma' + \Psi)\{(I - B)^{-1}\}' \tag{3}$$

and the covariance matrix between the endogenous variables and the exogenous variables is

$$\Sigma YY = Cov(Y, X) = (I - B)^{-1}(\Gamma\Phi) \tag{4}$$

Let Z be the vector of all variables: $Z = \begin{pmatrix} Y \\ X \end{pmatrix}$

Then its mean vector is: $\mu = E(Z) = \begin{pmatrix} \mu_Y \\ \kappa \end{pmatrix}$

and its variance matrix is: $\Sigma = Var(Z) = \begin{pmatrix} \Sigma_{YY} & \Sigma_{YX} \\ \Sigma_{YY}^{'} & \Phi \end{pmatrix}$

An additional path analysis was made suppressing the latent variable with the purpose of having a detailed analysis on the direct effects of *REG* and *LAW* in each of the dependent variables. The analytical formula of the path analysis model is, thus:

$$Y_{ij} = \beta_{ij} X_{ij} + \varepsilon_{ij} \tag{1}$$

where Y_{ij} represents the matrix of the variation of observed endogenous variables FDI and EXP (i=1 and 2 respectively over the j=1, …, 243 observations). β_{ij} represents the matrix of coefficients of the observed exogenous variables *GEO*, *GDPji*, *DK4*, *REG*, *LAW* , *PolCon* and *DiP*. The ε is the vector of error. The method for estimation in both models is the maximum likelihood.

4. ANALYSIS AND RESULTS

Statistical analysis in SEM presupposes variables with short ranges, normality, and no outliers (Kline, 2010; Bollen, 1990). With this in mind, the first step consisted of converting the variables *GEO*,

GDPji, *REG*, *LAW*, *PolCon*, *PER*, *BUD*, *EXP* and *FDI* into natural logarithms. Previously, *REG*, *LAW* and *PolCon* were rescaled to positive values. This procedure, essential to transforming the variables into comparable scales, also offered normality and eliminated almost all of the severe outliers. Only six outliers had to be removed after boxplot analysis, namely four in *BUD* and two in *DK4*.

The variables applied in the SEM model, *GEO*, *GDPji*, *REG*, *LAW*, *PolCon*, *DiP*, *EXP*, and *FDI* were examined for normality with univariate tests of Skewness and Kurtosis. All resulting values stayed below "1" and "3" respectively, which enabled their usage in SEM analysis (Bollen, 1989; Finney and DiStefanno, 2006). Additional inter-quartile tests reported mild outliers in *FDI* (n=1 in the lower quartile), *GDPji* (n=1 in the higher quartile), *DK4* (n=1 in the higher quartile), and *DiP* (n=1 and 3 respectively in the lower and higher quartile), though they hold adequate for SEM analysis (Hamilton, 2009).

Multicollinearity analysis is presented in Table 1. Due to the high correlation between *REG* and *LAW*, a variation inflation factor test (VIF) was conducted to screen for potential multicollinearity impact. VIF reported above the threshold of 10 (Myers, 1990) with *REG* listed at the top. In order to keep the variables in the model, an endogenous latent variable was included (*LEGAL*) being *REG* and *LAW* as formative measures. After regression with the *LEGAL* scores, VIF value depicted a maximum of 9.62; thus, all the variables were kept in the SEM analysis.

Table1 - Basic descriptive statistics of the variables

Construct	1. EXP	2. FDI	3. DK4	4. REG	5. LAW	6. PolCon	7. DiP (PER)	8. DiP (BUD)	9. GEO	10. GDPji
1. Contractual modes	1,00									
2. Ownership modes	0,81	1,00								
3. Informal constraints	-0,53	-0,48	1,00							
4. Formal constraints (Reg)	-0,59	-0,62	0,66	1,00						
5. Formal constraints (Law Enf)	-0,62	-0,63	0,62	0,94	1,00					
6. Political constraints	-0,47	-0,57	0,48	0,60	0,58	1,00				
8. Diplomatic Presence (Personnel)	0,24	0,18	0,17	0,19	0,10	0,06	1,00			
8. Diplomatic Presence (Budget)	0,63	0,50	-0,04	-0,09	-0,14	-0,16	0,63	1,00		
9. Geographical Distance	-0,51	-0,35	0,47	0,45	0,45	0,25	0,15	-0,05	1,00	
10. Gross Domestic Product	0,70	0,59	-0,33	-0,35	-0,34	-0,37	-0,17	0,46	-0,17	1,00
Mean	6,55	6,53	2,05	3,57	3,62	-0,99	3,14	14,60	8,17	-1,96
s.d.	1,74	2,48	1,58	0,73	0,77	0,67	1,31	0,86	1,00	1,90

n= 243

In order to avoid confirmation bias, as Kline (2010) suggests, the analysis was performed with alternative models. Of the three models presented, the first two are the SEM with the latent variable (LEGAL), with the direct and the moderate effects of political ties between countries. A third model, a path analysis, is added to gauge the regulatory (REG) and law enforcement (LAW) variances' direct effects on the governance modes (EXP and FDI). The three models were run with Stata software, version 12.

Considering the sensitivity of the chi-square test to the sample size (Bollen, 1989), the fit analysis of the first two models relies in the root mean squared error of approximation (RMSEA), the comparative fit index (CFI), and the Tucker-Lewis index (TLI) for relative indices, and residual size statistics as the standardized root mean squared residual (SRMR) or the coefficient of determination

(CD). The path analysis model is only reported by CD due to the lack of freedom degree (Kenny, Kaniskan, and McCoach, 2011; Kline, 2010).

The fit indexes reported outstanding values considering all the thresholds for continuous variables (Schreiber et al, 2006). In line with Hooper, Coughlan and Mullen (2008) guidelines, CFI and TLI reported at least 0.99, well above the 0.95 benchmark. The data adequacy to the statistical model is also verified through RMSEAs below 0.05 and non-significant p-close values of excellent fit benchmark. While model 1 reported an RMSEA of 0.040 (p-close=0.37), model 2 accounted an RMSEA of 0.033 (p-close=0.39). The SRMR in both models reported 0.01. Relative to the coefficient determinant (CD), the three models depicted were high above the 0.70 benchmark. Models 1 and 2 attained an explanatory power of 97 percent against 91 percent of the path analysis model. The graphical representation of the SEM models and path analysis are included in the Annexes.

Table 2 presents the SEM models (1 and 2) and respective reporting of the unstandardized and standardized coefficients of both direct and indirect effects, and the moderator role of the diplomatic network through the interaction of variables *PolCon* and *DiP*.

Table 2 - Unstandardized and standardized estimates and moderator effect

			SEM Model (1)				SEM Model (2)			
			EXP		FDI		EXP		FDI	
Control variables			coef	s.c.	coef	s.c.	coef	s.c.	coef	s.c.
Geographical Distance	GEO		-0,500 ***	-0,29	-0,222 **	-0,09	-0,501 ***	-0,29	-0,205 *	-0,08
Gross Domestic Product	GDPji		0,420 ***	0,46	0,417 ***	0,32	0,420 ***	0,46	0,460 ***	0,35
Direct effects										
Informal	DK4	**H1**	-0,112 ***	-0,10	-0,037	-0,04	-0,111 ***	-0,10	-0,097	0,06
Formal	LEGAL	**H2**	0,520 ***	-0,34	1,000 ***	-0,46	0,410 ***	-0,32	1,000 ***	-0,55
Political	PolCon	**H3a**	0,015	0,01	-0,654 ***	-0,18				
Diplomatic Presence (DiP)	DiP		0,430 ***	19,34	0,641 ***	0,33	0,606 ***	0,45	0,849 ***	0,44
Interaction										
Polcon* DiP		**H3b**					0,014	0,01	0,177 *	0,12
Indirect effects										
Regulatory				-0,15	-1,955	-0,21	-0,836	-0,16	-2,039	-0,27
Law enforcement				-0,12	-2,338	-0,16	-1,118	-0,11	-2,727	-0,19
RMSEA			0,040 p(close)= 0,37				0,033 p(close)= 0,39			
CFI			0,999				0,999			
TLI			0,993				0,995			
SRMR			0,001				0,001			
Pseudo R^2			0,968				0,967			

n= 243 note: *** p<0.01, ** p<0.05, * p<0.1

Hypothesis 1 predicts that large distances of the informal institutional environments between home and host country have a negative effect either in contractual or ownership modes of governance, wherein the effect on the latter is magnified by the extent of cultural friction (Shenkar, 2001). Although the coefficient signs confirmed the negative effect, the standardized coefficients show that similarity at the institutional elements' cognitive-cultural and normative level affects the contractual

modes more than the ownership modes. The p-values substantiate the analysis, while denoting no statistical significance relative to *FDI*. The low informal element effects are explained by Dow and Karunaratna (2006) as deriving from the presence of big mass control variables, such as GDP or geographic distance, in the present case *GEO* and *GDPji*.

The formulation of Hypothesis 2 was similar to Hypothesis 1, though it assessed the effect of dissimilarities between home and host legal environments on foreign operation governance. In an opposite direction as formulated, the dissimilarities between legal environments have stronger effect on ownership, though the standardized coefficients show that the formal elements of the institutional environment are of paramount importance for both contractual and ownership modes of governance. At first sight, the weaker effects of legal environment on the contractual modes would not confirm TCE assumptions (Williamson, 1975, 1985), or the wider perspectives of Coase (1937) on transactions costs. However, the results provided from the path analysis model, depicted in Table 3, distinguish different roles of regulatory and law enforcement. Whereas law enforcement only affects contractual modes ($p<0.05$), regulatory elements still have statistical significance to both governance modes, though with a stronger effect in owned foreign operations. In line with other empirical studies (Henisz, 2000b; Delios and Henisz, 2003a, 2003b), this exclusive relationship suggests that while law enforcement may seem an important guarantee for settling post-contractual conflicts, the regulatory environment is more pertinent for undertaking local operations.

Table 3 - Direct effects of Regulatory and Law Enforcement variables

		Path analysis			
		EXP		FDI	
Control variables		coef	s.c.	coef	s.c.
Geographical Distance	GEO	-0,499 ***	-0,29	-0,227 **	-0,09
Gross Domestic Product	GDPji	0,421 ***	0,46	0,415 ***	0,32
Direct effects					
Informal	DK4	-0,114 ***	-0,10	-0,058	0,04
Formal					
Regulatory	REG	-0,283 *	-0,12	-1,010 ***	0,30
Law Enforcement	LAW	-0,336 **	-0,15	-0,218	0,07
Political	PolCon	0,014		-0,649 ***	0,17
Diplomatic Presence (DiP)	DiP	0,586 ***	0,45	0,655 ***	0,44
Pseudo R^2		0,911			

n= 243 note: *** p<0.01, ** p<0.05, * p<0.1

Hypothesis 3a and 3b examined the direct effect of political environment constraints and political ties' moderator effect on internationalization's governance modes, respectively. The results clearly indicate that dissimilarities between political environments negatively affect ownership modes. Moreover, the p-values indicate that the effect of political constraints on contractual and ownership modes only have

statistical significance within the latter. Hypothesis 3b was formulated in line with 3a, and, in accordance with Henisz's call, the political links reversed the negative effect of political constraints. While irrelevant to contractual modes, the moderator role of the *DiP* variable inverted the *PolCon* effect on *FDI* from a coefficient of -0.18 (negative) to 0.12 (positive) when *PolxDiP* was included. Surprisingly, not only does the diplomatic network (*DiP*) have a relevant moderator effect on the environmental constraints from dissimilarities (*PolCon*), but also its direct effect is highly significant ($p<0.001$), both on contractual and ownership modes (standardized coefficients of 0.44 and 0.34, respectively). The high statistical significance ($p<0.001$) and the bulk coefficients in both models related to diplomatic network intensity (*DiP*) provide this study a larger contribution than expected. Political ties between countries, more than a moderating variable as suggested by Henisz (2000b), may actually be an important international trade and FDI intensity predictor.

5. DISCUSSION AND CONCLUSIONS

In the search for government ties' moderating role on the political constraints of institutional environments between countries, this study investigated whether the informal, formal, or political dissimilarities between home and host country affects internationalization's governance modes. While the political environment was found to affect ownership modes, the informal environment seems to matter only for contractual modes. The results regarding the formal environment are of particular interest when disaggregated in its formative variables. The regulatory and judicial environments have stronger effects on ownership and contractual modes, respectively. The divergences of the hypotheses' results from their theoretical ground make the current research even more pertinent.

The informal environment and knowledge

The informal institutional environment similarity between countries did not have any effect on the ownership mode of internationalization. This finding diverges from some mainstream international business conceptualizations. Process studies, including entry sequence (Anderson and Gatignon, 1986; Madhok, 1998; Paul and Wooster, 2008; Petersen, Welch and Benito, 2010), foreign operation establishment (Johanson and Vahlne, 1977; Chang, 1995; Chang and Rosenzweig, 2001), or expansion in similar cultural blocks (Barkema, Bell and Pennings, 1996; Barkema and Drogendijck, 2007) suggest an incremental pace of foreign operations aligned with either cultural distance (Brouthers, 2002) or psychic distance (Johanson and Widersheim-Paul, 1975; Petersen and Pedersen, 1999). Learning processes (Forsgren, 2002) and knowledge transfer and deployment effectiveness (Bresman, Birkinshaw and Nobel, 1999; Birkinshaw, 2001; Ciabuschi, Dellestrand, and Holm, 2012) provide grounds for multinationals to invest more intensively in countries with similar cultural environments in order to reduce cultural friction losses (Shenkar, 2001; Shenkar, et al, 2008). The similarity of cultural-cognitive and normative elements between home and host countries drives fast learning and increased subsidiary performance (Barkema and Drogendijk, 2007). Studies on international strategy

substantiate this idea, advocating that subsidiaries in culturally similar countries are easier to control and coordinate, and reveal higher performance than culturally distant ones (Dellestrand and Kappen, 2012). Therefore, a higher degree of ownership would be expected in the presence of greater informal environment similarities. In the present study, however, not only did contractual modes have stronger effects from informal elements, but also ownership modes did not reveal any statistically significant association with informal home and host country cultural dissimilarities. Giving clues to this effect, some other international strategy researchers support that cultural similarities avoid product customization; thereby, global strategies such as exports may be adopted over ownership modes (Doz and Prahalad, 1984; Doz, Santos and Williamson, 2001). This later stream of research, however, does not include other external uncertainty factors, such as the legal and political ones. Moreover, when included – as in the present study – it emerges that internationalization's governance modes may be better explained in uncertainty factors rather than in knowledge grounds.

The governance modes and the regulatory environment

The formal institutional environment aspects were found to have robust effects both in contractual and ownership modes. Yet, regulatory and judiciary element disaggregation reveals different effects on each mode. While the judiciary dimension effect on the contractual mode – being stronger than on the ownership mode – is in accordance with the hypotheses and, therefore, with Williamson's (1975) TCE fundamentals, the effect of the regulatory dimension on the ownership mode strengthens reassessing Coase's (1937) transaction costs approach.

The prevalence of regulatory elements over judicial elements devolves the horizontal integration dimension to transaction costs as originally conceptualized by Coase (1937). Unlike Williamson's 1975 transaction cost operationalization, Coase's structural approach not only included vertical, but also horizontal integration, which is held in his concept of "combination". As argued by Coase, efficiency is a primary market feature, whereas firms only exist when they are able to coordinate a transaction more efficiently than the market. This does not mean, however, that efficiency should be a feature of the firm rather than of the market. As Coase (1937:29) poses, "to determine the [efficient] size of the firm," it is necessary to determine the market transaction costs as well as the costs of organizing the different firms, such that production can be known for each firm. The regulatory environment not only helps with the defection of opportunism between the buyer and supplier, but also with the organization of different firms, such as among competitors.

The results' statistical significance, as well as their coefficients' amplitude, are unequivocal. Whereas courts and the law affect contractual modes, regulations and property rights affect ownership modes. The proxies employed in this study illustrate the efficient acknowledgment between the regulatory and judicial environments. In foreign operations held by exports, most of the activities are undertaken at home. The product's compliance with host market regulations is a contractual matter often included by the foreign client (Leonidou, Barnes and Talias, 2006). As empirically sustained by

Macauley (1963), contracts may serve as a technical specification rather than a legal enforcement. Once the event of any severe conflict normally arises at the delivery into the host market, in the context of contractual modes, courts and law become of paramount importance compared with regulations.

By contrast, ownership modes require local regulation acknowledgment, such as construction licenses, industrial and commercial permits, or labor regulations (Delios and Henisz, 2003a, 2003b). That is, before any eventual severe conflict, firms have to cope first with the regulatory environment, as they have to carry out their local activities. Therefore, regulatory efficiency minimizes conflicts and avoids any eventual judicial disputes. Whereas contractual modes seem to economize on the similarities between legal environments, ownership seeks to minimize internal and avoid external uncertainties caused by home and host country regulatory environment dissimilarity.

Internationalization, political links and environment dissimilarities

The results clearly indicate that governance modes in internationalization are strongly influenced by the institutional environment's political elements, whereas no relationship is found with contractual modes. Expropriation risk explains this lack of effect on contractual modes, though it may be not enough to explain the effect on ownership modes. As suggested by Henisz and Williamson (1999), and further validated empirically by Henisz (2000b), while transactional hazards can always be internalized through ownership, political hazards must be balanced and calculated whether the benefits of transactional internalization do, or do not, balance expropriation risk. This rationale only looks upon host country environment, and the likelihood to invest in politically hazardous countries would be low and fully independent of the host country's political environment.

The findings in this paper are more complete to the extent that they show the relation between foreign-owned operations and the similarity of home and host country political environments. As important as the quality of the host country's institutional environment is, similarly is the firm's ability to manage political hazards, which derives from the experience gained in similar environments – whether from the multinationals' home country (Perkins, 2008, 2009) and industries (Henisz, 2003), or from previously owned foreign operations conducted in similar political environments (Delios and Henisz, 2003a, 2003b). As addressed before, the similarity between political environments assists firms to predict policy change and, thus, to be prepared to cope with it.

Although predictability is paramount for dealing with "non-internalizable" political hazards, less reactive and more proactive strategies are also available for multinationals. The elective nature of political structures subjects them to interest group influence that blocks or pressures for policy change (see Henisz and Zelner, 2004, 2006). Hence, more than the advantage endowed by predictability to be prepared for policy change, influence enables change to be steered toward a certain group's discrete interests. As Boddewyn and Brewer (1994) suggested, policy change does not have to be detrimental; it just needs to meet one's expectations to be beneficial. However, the effort is not limited to steering

policy change to the "right" direction, but also to ensuring the desired change's sustainability. The social context in which political institutions are embedded implicitly regulates policy change within the limits of "common interest", stringing political institutions to maintain a behavior of "probity" (Williamson, 1999). Policy change is sustainable only if legitimate (Henisz and Zelner, 2004).

The diplomatic moderating effect on political constraints substantiates influence's legitimacy rationale, extending it to the international arena. The insights are twofold, as are the two different audiences at stake. Whereas at home close relationships between firms and governments may appear illegitimate, across borders they may be seen as legitimate, as they maintain the common national interest. For instance, the relationships of home governments' diplomatic networks with their multinationals becomes more legitimate the greater the opportunistic host government behavior, or opportunistic local actor manipulation (Henisz and Williamson, 1999; Henisz, 2000b, Henisz and Macher, 2004). Not only do governments use their multinationals to pursue political goals of national interest, but also multinationals in turn may use governmental resources abroad to protect the private property of common interest to nationals (Nigh, 1985).

Diplomatic networks' significant and strong effects on contractual modes magnify the political role in the internationalization phenomenon. While the diplomatic network's moderating effect is mostly oriented to reduce the constraints of political dissimilarities in ownership modes, the direct effects are highly significant in both ownership and contractual modes, being even stronger for the latter. This effect may be explained by diplomatic networks' ex-ante role in the contractual mode given its lack of any property hazards. Another more interesting explanation is the complementary role diplomatic ties may have in settling ex-post disputes of contractual conflicts. The results of the formal elements' de-aggregration support this. In a similar way to explaining the effect of law and the judiciary on contractual modes, diplomatic networks may be an important part to safeguarding rents with sources in contractual modes.

Limitations of the study

The first of some of this study's limitations concerns the sample. The sensitive material that diplomatic networks represent to some governments restricted the study's initial aim. Instead of bilateral relations among 38 countries, the research was restricted to the unilateral relations of three countries within a set of 120 countries. Moreover, only developed countries responded. Although the sample size allowed reliable statistical results, it would be of major interest to compare the perspectives between developed and developing, or emerging, countries. The second limitation concerns the proxies used to measure the political ties. Besides the diplomatic network index used in this study, other measures may also be employed to proxy political ties, such as the national debts between countries. The third issue relates to the study's cross-sectional feature. Given that most of the other measures are available in a longitudinal time series, it would be of interest to infer diplomatic network dynamics. However, it would be the source of even more complication by adding the

difficulty with the data collection from the ministries of foreign affairs. These limitations compel further research, namely with a multinational team located in each country to enforce data collection in the unobserved countries. The joint effort would also allow building a longitudinal and more sophisticated measure of political ties among countries.

Contributions

Despite the limitations of this study, several contributions are provided. First, it reassesses fundamental assumptions of Coase's (1937) perspective on transaction costs, namely his definition of "combination". Williamson (1975) claimed to operationalize Coase's approach into a theory through including TCE opportunism. However, because opportunism only results with vertical integration, horizontal integration has been excluded from the ensuing literature related with TCE. With the shift from a domestic to an international scope, Henisz and Williamson's (1999) model gained the potential to include horizontal integration in the analysis; still, it stayed limited to the internal uncertainty scope of opportunistic host government manipulation by local partners with no other analysis undertaken out of the relationship logic between buyer and supplier. Competitors, although referenced, remained out of the model. The present study, even in a thin form, highlights the external uncertainty alignment within the organization costs of markets among countries. Exposing the formal environment distinction in regulatory and judicial enforcement, it opens the issue of horizontal integration in transaction costs as addressed by Coase (1937, 1960). Therefore, the ownership mode of foreign operations may not stay restricted to the logic of internalization to circumvent buyer and supplier opportunism but, instead, spill off as a consequence of transactional inefficiency related to the legal mismatch between countries.

The second contribution concerns methodology. The internationalization's governance mode vis-à-vis institutional distance is often measured through binomial variables of equity and non-equity entries or ordinal variables regarding foreign operation establishment stages. Categorical and ordinal variables, though avoiding common bias problems, still have scant explanatory power and endow limited interpretations (Podsakoff, Scott, Lee and Podsakoff, 2003). In this study, the dependent variable measures are continuous and not categorical. While the structural equation model's fit is more complex with continuous variables, its results are more reliable and allow broader generalizations (Kline, 2010). Additionally, the macro data employed to observe dependent variables, while avoiding common bias, did not suffer any kind of particularization or industry subset selection, which makes the results more resistant to being challenged in future studies.

Third, and eventually the most substantial contribution, is the establishment of diplomatic presence intensity as a new measure for gravity models on international trade and foreign investment. The high statistical significance of the diplomatic network intensity variable, even in the presence of huge mass control variables such as GDP and geographical distance, as well as its strong direct effects

on the dependent variables – Exports and FDI – reveals a strong predictive and explanatory power that merits consideration in further research in the international field.

Conclusions and implications

The findings in this study reveal that multinationals are neither homeless organizations where uncertainty only stems from host countries, nor is knowledge enough to explain the governance choice of foreign operations. The conventional theories that view internationalization as a strategic process of choices endogenous to the firms, or as bounded within the markets, may not be sufficient to predict the phenomenon in its entirety. Internationalization is complex with cross-dependencies among exogenous elements of the environment. Multinationals are not able to fully manage their internationalization solely through the exploitation of their specific advantages and control of external uncertainties (Hymer, 1960/76), nor do environmental elements dictate the actions of submissive multinationals (Forsgren, 2008). More than adapting to environmental demands or arbitrating the differences between institutional environments (Dunning, 1988; Henisz, 2000a), multinationals do combine their foreign investments with governmental resources abroad to moderate the differences of the host country's institutional environment.

Although the governance modes in internationalization have been shown to be strongly influenced by regulatory and political institutional environments, it may be too ambitious to conclude that governments are actually driving multinationals' internationalization. However, influence and pressure fall short on describing the actual role of the governments in the internationalization phenomena. Combination arises as the ultimate strategy, not only for multinationals to capture the externalities of their public assets abroad, but also for governments to reap politically the economic strength of their multinationals' foreign presence. National interest legitimizes and coordinates this implicit combination of public and private resources beyond national borders. Interestingly, the control of foreign operations deriving from ownership was found to be shared by both governments and multinationals, whether through diplomatic networks or by integration of the 'internalizable' elements of the environment. Hence, more than influence, governments are actually taking part in the internationalization of multinationals. Furthermore, observing this combination pattern between firms' and governments' resources opens new research avenues toward the study of their interaction within an industrial logic of value creation. Important policy implications may arise henceforth.

REFERENCES

Ahlquist, J. S. 2006. Economic Policy, Institutions, and Capital Flows: Portfolio and. Direct Investment Flows in Developing Countries. *International Studies Quarterly*, 50: 687-710.

Anderson, E. & Gatignon, H. 1986. Modes of foreign entry: a transaction cost-analysis and propositions. *Journal of International Business Studies*, 17(3): 1-26

Barkema, H.G., Bell, J. & Pennings, J.M. 1996. Foreign entry, cultural barriers, and learning. *Strategic Management Journal*, 17(2): 1-51.

Barkema, H.G. & Drogendijk, H.J. 2007. Internationalizing in small, incremental or larger steps? *Journal of International Business Studies*, 38(7): 1132-1148

Bengtsson, A., Hadjikhani, A. & Pahlberg, C. 2009. Adding Political Dimension to Business Research. *International Journal of Business Environment*, 2 (4): 391-399.

Birkinshaw, J. 2001. Why is Knowledge Management So Difficult?. *Business Strategy Review*, 12 (1): 11-18

Blonigen, Bruce A. 2001. In Search of Substitution Between Foreign Production and Exports. *Journal of International Economics*, 53(1): 81-104.

Blonigen, Bruce A. 2005. A review of the empirical literature on FDI determinants. *Atlantic Economic Journal*, 33(4): 383–403.

Boddewyn, J. 1988. Political Aspects of MNE Theory. *Journal of International Business Studies*, 19(3): 341-363.

Boddewyn , J. & Brewer, T. 1994. International Business Political Behavior: New Theoretical Directions. *Academy of Management Review*, 19(1): 119-143

Bollen, K.A. 1989. *Structural Equations with Latent Variables*. Wiley: New York

Bollen, K.A. 1990. Overall fit in covariance structure models: two types of sample size effects *Psychological Bulletin*, 107: 256–259

Bradley, D. 1977. Managing Against Expropriation. *Harvard Business Review*. July-August: 75-83.

Bresman H., Birkinshaw J. & Nobel, J. 1999. Knowledge transfer in international acquisitions. *Journal of International Business Studies*, 30 (3): 439–462

Brouthers, K.D. 2002. Institutional, Cultural and Transaction Cost Influences on Entry Mode Choice and Performance. *Journal of International Business Studies*, 33(2), 203–222.

Brouthers K.D. & Brouthers, L.E. 2000. Acquisition or greenfield start-up? Institutional, cultural and transaction cost influences. *Strategic Management Journal*, 21: 89-97.

Casson, M. C. 1987. *The Firm and the Market: Studies in Multinational Enterprises and the Scope of The Firm*. Cambridge, Mass: MIT Press and Oxford: Blackwell, 283.

Chang, S. J. 1995. International expansion strategy of Japanese firms: Capability building through sequential entry. *Academy of Management Journal*, 38 (2): 383-407.

Chang, S. J. & Rosenzweig, P. M. 2001. The choice of entry mode in sequential foreign direct investment. *Strategic Management Journal*, 22 (8): 747-776.

Ciabuschi, F., Dellestrand, H. & Holm, U. 2012. The Role of Headquarters in the Contemporary MNC. *Journal of International Management*, 18(3): 213-223.

Click, R. & Weiner, R. 2010. Resource nationalism meets the market: Political risk and the value of petroleum reserves. *Journal of International Business Studies*, 41: 783–803.

Commons, J.R. 1931. Institutional Economics. *American Economic Review*, 21: 648–657

Coase, R. H. 1937. The Nature of the Firm. *Economica*, 4 (16): 386–405

Coase, R. H. 1960. The Problem of Social Cost. *Journal of Law and Economics*, 3: 1–44.

Coase, R H. 1992. The Institutional Structure of Production. *American Economic Review*, 82(4): 713-19

Contractor, F. J. & Lorange, P. 1988a. Cooperative Strategies in International Business, Lexington, MA: Lexington Books

Contractor, F. J. & Lorange, P. 1988b. Competition vs. Cooperation: A Benefit/Cost Framework for Choosing Between Fully-Owned Investments and Cooperative Relationships, in Beamish, P. W. (eds.) *Strategic Alliances*, Cheltenham, UK, Northampton, MA, USA: Edward Elgar Publishing, 5-18

Contractor, F.J. & Lorange, P. 2002. *Cooperative Strategies and Alliances*, Contractor, F.J. and Lorange, P. (eds), Oxford: Elsevier.

Delios, A. & Beamish, P. 2001. Survival and profitability: The roles of experience and intangible assets in foreign subsidiary performance. *Academy of Management Journal*, 44(5): 1028-1038.

Delios, A. & Henisz, W. 2003a. Political hazards and the sequence of entry by Japanese firms, 1980-1998. *Journal of International Business Studies*, 34(3): 227-241.

Delios, A. & Henisz, W. 2003b. Political Hazards, Experience and Sequential Entry Strategies: The International Expansion of Japanese Firms, 1980-1998. *Strategic Management Journal*, 24(12): 1153-1164.

Dellestrand, H. & Kappen, P. 2012. The effects of spatial and contextual factors on headquarters resource allocation to MNE subsidiaries. *Journal of International Business Studies*, 43(3): 219–243.

Disdier, A.-C. & Head, K. 2008. The puzzling persistence of the distance effect on bilateral trade. *The Review of Economics and Statistics*, (90)1:37-48.

Doz, Y. & Prahalad, C. K. 1984. Patterns of strategic control within multinational corporations. *Journal of International Business Studies*, 15: 55–72.

Dow, D. & Karunaratna, A. 2006. Developing a multidimensional instrument to measure psychic distance stimuli. *Journal of International Business Studies*, 37(5):575-577.

Dow, D. & Ferencikova, S. 2010. More than just national cultural distance: Testing new distance scales on FDI in Slovakia. *International Business Review*, 19(1):46-58.

Doz, Y., Santos, J. & Williamson, P. 2001. *From Global to Metanational: how companies win in the knowledge economy*, Boston: Harvard Business School Press.

Dunning, J. H. 1988. The eclectic paradigm of international production: A restatement and some possible extensions. *Journal of International Business Studies*, 19: 1-31.

Easterlin, R. 1981. Why Isn't the Whole World Developed?. The Journal of Economic History, 41(1), *The Tasks of Economic History*, 1-19

Erramilli, M. 1991. The experience factor in foreign market entry behavior of service firms. *Journal of International Business Studies*, 22(3):479-501.

Erramilli, M. & Rao, C. 1993. 'Service firms' international entry mode choice: A modified transaction-cost analysis approach. *Journal of Marketing*, 57(3):19-38.

Fieler, A. 2011. Nonhomotheticity and Bilateral Trade: Evidence and a Quantitative Explanation. *Econometrica*, 79(4): 1069–1101

Finney, S. J. & DiStefano, C. 2006. Non-Normal and Categorical Data in Structural Equation mMdeling, in G. R. Hancock and R. O. Mueller (eds.), *Structural Equation Modeling: A Second Course* (pp. 269-314). Greenwich, CT: Information Age.

Forsgren, M. 2002. The Concept of Learning in the Uppsala Internationalization Process Model. *International Business Review*, 11(3): 257-278

Forsgren, M. 2008. *Theories of the Multinational Firm. A Multidimensional Creature in the Global Economy*. Edward Elgar.

Frankel, J. & Rose, A. 2002. An Estimate Of The Effect Of Common Currencies On Trade And Income. *The Quarterly Journal of Economics*, 117(2): 437-466

Gatignon, H. & Anderson, E. 1988. The Multinational Corporation Degree of Control over Subsidiaries: An Empirical Test of a Transaction Cost Explanation, *Journal of Law, Economics and Organization*, 4: 305-366

García-Canal, E. & Guillén, M.F. 2008. Risk and the strategy of foreign location choice in regulated industries, *Strategic Management Journal*, 29(10): 1097–1115.

Globerman, S. & Shapiro, D. 2003. Governance infrastructure and U.S. foreign direct investment. *Journal of International Business Studies*, 34: 19-39.

Hadjikhani, A. & Ghauri, P.N. 2001. The Behaviour of International Firms in Socio-Political Environments in the European Union. *Journal of Business Research*, 52(3): 263-275

Hadjikhani, A. & Ghauri, P. N. 2006. Multinational Enterprises and Their Lobbying Activities in the European Union, in: Oxelheim, L. (ed.) *Corporate and Institutional Transparency for Economic Growth in Europe, International Business and Management*, Elsevier, Amsterdam, New York, London: 371-397.

Hadjikhani, A., Lee, J-W. & Ghauri, P. 2008. Network view of MNCs' socio-political behavior. *Journal of Business Research*, 61, 912–924

Hamilton, L. C. 2009. *Statistics with Stata, updated for version 10*. Pacific Grove, CA: Cengage.

Hedlund G. & A. Kverneland .1985. Are strategies for foreign markets changing? The case of Swedish investment in Japan. *International Studies of Management and Organization*, (15) 2: 41 -59.

Helpman, E., Melitz, M. & Yeaple, S. 2004. Export Versus FDI With Heterogeneous Firms. *American Economic Review*, 94(1): 300-316.

Henisz, W. 2000a. The institutional environment for economic growth. *Economics and Politics*, 12(1): 1-31.

Henisz, W. 2000b. The Institutional Environment for Multinational Investment. *Journal of Law, Economics and Organization*, 16(2): 334-64,

Henisz, W. 2003. The Power of the Buckley and Casson Thesis: The Ability to Manage Institutional Idiosyncrasies. *Journal of International Business Studies*, 34(2): 173-84

Henisz, W. 2009. Beyond the Economic Institutions of Strategy: Strategic Responses to Institutional Variation. In Nickerson, Jackson & Brian Silverman, (Eds.), *Economic Institutions of Strategy*. New York: JAI Press

Henisz, W. & Delios, A. 2001. Uncertainty, Imitation, And Plant Location: Japanese Multinational Corporations, 1990-1996. *Administrative Science Quarterly*, 46(3): 443-75

Henisz, W. & Delios, A. 2004. Information or Influence? The Benefits of Experience for Managing Political Uncertainty. *Strategic Organization*, 2(4): 389-421

Henisz, W. & Macher, J. 2004. Firm- and Country-Level Tradeoffs and Contingencies in the Evaluation of Foreign Investment: The Semiconductor Industry, 1994-2002. *Organization Science*, 15(5): 537-54.

Henisz, W. & Zelner, B. 2003. The Strategic Organization of Political Risks and Opportunities, *Strategic Organization* 1(4): 451–60.

Henisz, W. & Zelner, B. 2004. Explicating Political Hazards: A Transaction Cost Politics Approach. *Industrial and Corporate Change*, 13(6): 901-15.

Henisz, W. & Zelner, B. 2005. Legitimacy, Interest Group Pressures and Institutional Change in Emergent Institutions: The Case of Foreign Investors and Home Country Governments. *Academy of Management Review*, 30(2): 361-82.

Henisz, W. & Zelner, B. 2006. Interest Groups, Veto Players and Electricity Infrastructure Deployment. *International Organization*, 60(1): 263-86.

Henisz, W. & Williamson, O. E. 1999. *Comparative Economic Organization -- Within and Between Countries*. Business and Politics, 1(3): 261-77.

Hitt, M., Keats, W. & DeMarie, S. (1998) Navigating in the new competitive landscape: Building strategic flexibility and competitive advantage in the 21st century. *Academy of Management Executive*, 12(4): 22-42.

Hitt, M., Franklin, V. & Zhu, H. 2006. Culture, institutions and international strategy. *Journal of International Management*, 12, 222–234.

Hofstede, G. 1980. *Cultures Consequences: International Differences in Work-Related Values*. Sage Publications, Beverly Hills, California, USA.

Hooper, D., Coughlan, J. & Mullen, M. R. 2008. Structural Equation Modelling: Guidelines for Determining Model Fit. *Electronic Journal of Business Research Methods*, 6(1)

House, R., Hanges, P., Javidan, M., Dorfman, P. & Gupta, V. 2004. *Culture, leadership and organizations: The GLOBE study of 62 societies*. SAGE.

Hymer S.H. 1960/76. *The International Operations of National Firms: A Study of Foreign Direct Investment*, Doctoral dissertation, Cambridge, MA: The MIT Press

Johanson, J. & Vahlne, J. 1977. The internationalization process of the firm, *Journal of International Business Studies*, 8: 23-32.

Johanson, J. & Wiedersheim-Paul, F. 1975. The Internationalization of the Firm: Four Swedish Cases, *Journal of Management Studies*, 12 (3): 305-322.

Katsikeas, C., Leonidou, L. & Samiee, S. 2008. Research into exporting: Theoretical, methodological, and empirical issues. In *Handbook of International Marketing*, edited by M. Kotabe and K. Helsen, London: Sage Publications, 165-182

Kaufmann, D., Kraay, A. & Mastruzzi, M. 2010. The Worldwide Governance Indicators: Methodology and Analytical Issues. World Bank Policy Research, Working Paper No. 5430.

Kenny D., Kaniskan, B. & McCoach, D. 2011. How Small is Too Small? The Performance of RMSEA in Models with Small Degrees of Freedom. Unpublished paper, University of Connecticut

Kline, R.B. 2010. *Principles and practice of structural equation modeling* (3rd ed.). New York: Guilford Press.

Kogut, B. & Singh, H. 1988. The effect of national culture on the choice of entry mode. *Journal of International Business Studies*, 19(3):411-32.

Kostova, T., Roth, K. & Dacin, M. T. 2008. Institutional theory in the study of multinational corporations: A critique and new directions. *Academy of Management Review*, 33(4): 994-1006.

La Porta, R., Lopez-de-Silanes, F. & Shleifer, A. 2008. The Economic Consequences of Legal Origins. *Journal of Economic Literature*, 46: 285–332.

Leonidou, L., Barnes, B. & Talias, M. (2006) Exporter–importer relationship quality: The inhibiting role of uncertainty, distance, and conflict. *Industrial Marketing Management*, 35(5): 576-588

Leonidou L.C. & Katsikeas, C.S. 1996. The export development process: An integrative review of empirical models, *Journal of International Business Studies*, 27(3): 517-551

Macaulay, S. 1963. Non contractual relations in Business: A Preliminary Study. *American Sociological Review*, 28(1): 55-67.

Madhok, A. 1998. The nature of multinational firm boundaries: Transaction costs, firm capabilities and foreign market entry mode. *International Business Review*, 7: 259-290.

Malhotra, N. & Hinings, C. 2010. An organizational model for understanding internationalization processes. *Journal of International Business Studies*. 41(2): 330-349.

Maekelburger, B., Schwens, C. & Kabst, R. 2012. Asset specificity and foreign market entry mode choice of small and medium-sized enterprises: The moderating influence of knowledge safeguards and institutional safeguards. *Journal of International Business Studies*, 43: 458–476.

Makino, S. & Tsang, E. 2011. Historical ties and foreign direct investment: An exploratory study. *Journal of International Business Studies*, 42: 545-57.

Mayer, T. & Zignago, S. 2011. Notes on CEPII's distances measures (GeoDist), CEPII Working Paper 2011-25. (http://www.cepii.fr/anglaisgraph/bdd/distances.htm#sthash.TjY2tZMq.dpuf).

Myers, R. H. 1990. *Classical and modern regression with applications (second ed.)*.Boston: PWS-Kent Publishing Company.

Naray, O. 2011. Commercial Diplomats in the context of International Business. *The Hague Journal of Diplomacy*, 6, 121-148.

Nigh, D. 1985. The effect of political events on United States direct foreign investment: A pooled time-series cross-sectional analysis. *Journal of International Business Studies*, 16(1):1-17.

Nigh, D. 1992. Who's on first? Nation-states, national identity, and multinational corporations. In Toyne, B. and Nigh, D., editors, *International Business: An Emerging Vision*, pages 257-68. University of Southern Carolina Press, Columbia, South Carolina, USA, 1st edition.

North, D. C. 1990. *Institutions, Institutional Change and Economic Performance*, Cambridge: Cambridge University Press.

North, D. C. 1991. Institutions. *Journal of Economic Perspectives*, 5(1): 97–112.

North, D. C. 2005. *Understanding the process of economic change*. Princeton, NJ: Oxford University Press.

Pan, Y. & Tse, K. 2000. The hierarchical model of market entry modes, *Journal of International Business Studies*, 31(4), 535-554

Paul, D. & Wooster, R. 2008. Strategic Investments by U.S. Firms in Transition Economies, *Journal of International Business Studies*, 39(2): 249-266.

Peng, M. 2003. Institutional transitions and strategic choices. *Academy of Management Review*, 28(2): 275–296.

Petersen, B. & Pedersen, T. 1999. Fast and slow resource commitment to foreign markets. What causes the difference? *Journal of International Management*, 5: 73-91

Petersen B., Welch, L. & Benito, G. 2010. Managing the Internalisation Process, *Managing International Review*, 50: 137–154

Pinto, P. & Pinto, S. 2008. The Politics of Investment: Partisanship and the Sectoral Allocation of Foreign Direct Investment. *Economics & Politics*, 20(2): 216-254.

Perkins, S. 2008. When does prior experience pay? Institutional experience and the case of multinational corporation, Working Paper, http://papers.ssrn.com/sol3/papers.cfm?abstract_id =1088251, accessed 17 February 2012.

Perkins, S. 2009. Defining institutional similarity: The multidimensions of global industry regulation, Working Paper, http://www.kellogg.northwestern.edu/Faculty/Directory/ Perkins_Susan_E.aspx#research, accessed 17 February 2012.

Poppo, L. & Zenger. B. 2002. Do Formal Contracts and Relational Governance Function as Substitutes or Complements? *Strategic Management Journal*, 23(8), 707-725.

Podsakoff, P., Scott, M., Lee, J-Y. & Podsakoff, N. 2003. Common Method Biases in Behavioral Research: A Critical Review of the Literature and Recommended Remedies, *Journal of Applied Psychology*, 88 (5): 879–903.

Reid, R.S. 1981. The Decision-maker and Export Entry and Expansion, *Journal of International Business Studies*, 12(2), 101-112.

Sawant, R. J. 2010. The economics of large-scale infrastructure FDI: The case of project finance." *Journal of International Business Studies* 41 (6): 1036-55.

Schnitzer, M. 2002. Debt v. Foreign Direct Investment: The Impact of Sovereign Risk on the Structure of International Capital Flows. *Economica*, 69: 41-67.

Scott, R. 1995. *Institutions and Organizations*. Thousand Oak, CA: Sage

Scott, R. 2005. Institutional theory: contributing to a theoretical research program. In: Smith, K., Hitt, M. (Org.). *Great minds in management: the process of theory development*. Oxford: Oxford University Press: 460-484

Schreiber, J. B., Nora, A., Stage, F. K., Barlow, E. A. & King, J. 2006. Reporting structural equation modeling and confirmatory factor analysis results: A review. *The Journal of Educational Research*, 99(6), 323-338.

Shenkar, O. 2001. Cultural distance revisited: Towards a more rigorous conceptualization and measurement of cultural differences. *Journal of International Business Studies*, 32(3): 519–535.

Shenkar, O., Luo, Y. & Yeheskel, O. 2008. From "distance" to "friction": Substituting metaphors and redirecting inter-cultural research. Academy of Management Review, 33(4): 905–923

Simonis, J. 2001. Institutions and the imperfect market, *International Journal of Social Economics*, 28(3): 295 - 307

Schwartz, S. H. 1994. Beyond individualism/collectivism: New cultural dimensions of values. In U. Kim, H. C. Triandis, C. Kagitcibasi, S. C. Choi, & G. Yoon (Eds.), *Individualism and collectivism: Theory, methods, and applications* (pp. 85–119). Thousand Oaks: Sage Publications.

Westney, E .1993. Institutionalization theory and the multinational corporation. In S. Ghoshal & E. Westney (Eds.), *Organization theory and the multinational corporation*: 53-75. New York: St. Martin's Press.

Williamson, J. & Santos, J. 2010. Reverse Takeovers: Emerging Economy Companies Acquiring in Advanced Economies, Proceedings of the 52nd Annual Meeting of Academy of International Business

Williamson, O. E. 1975. *Markets and Hierarchies. Analysis and Antitrust Implications*, New York: Free Press.

Williamson, O. E. 1981. The Economics of *Organization:* The Transaction Cost Approach. *American Journal of Sociology*, 87(3): 548-577

Williamson, O. E. 1985. *The Economic Institutions of Capitalism*. New York: Free Press.

Williamson, O. E. 1999. Public and Private Bureaucracies: A Transaction Cost Economics Perspective. *Journal of Law, Economics, and Organization,* 15 (1): 306-347.

Yamin, M. 1991. A reassessment of Hymer's contribution to the theory of the transnational corporation. In Pitelis, Ch. Sugden, R. (eds), *The Nature of the Transnational Firm*. London: Routledge.

Yamin M. & Golesorkhi, S. 2010. Cultural distance and the pattern of equity ownership structure in international joint ventures, *International Business Review*, 19(5): 457-467.

Zaheer, S. 1995. Overcoming the liability of foreignness. *Academy of Management Journal*, 38(2): 341-63.

Zaheer, S. & Mosakowski, E. 1997. The dynamics of the liability of foreignness: A global study of survival in financial services. *Strategic Management Journal*, 18(6):439-64.

Zhou, Z., Poppo, L. & Yang, Z. 2008. Relational Ties or Customized Contracts? An Examination of Alternative Governance Choices in China. *Journal of International Business Studies*, 39, 526-534.

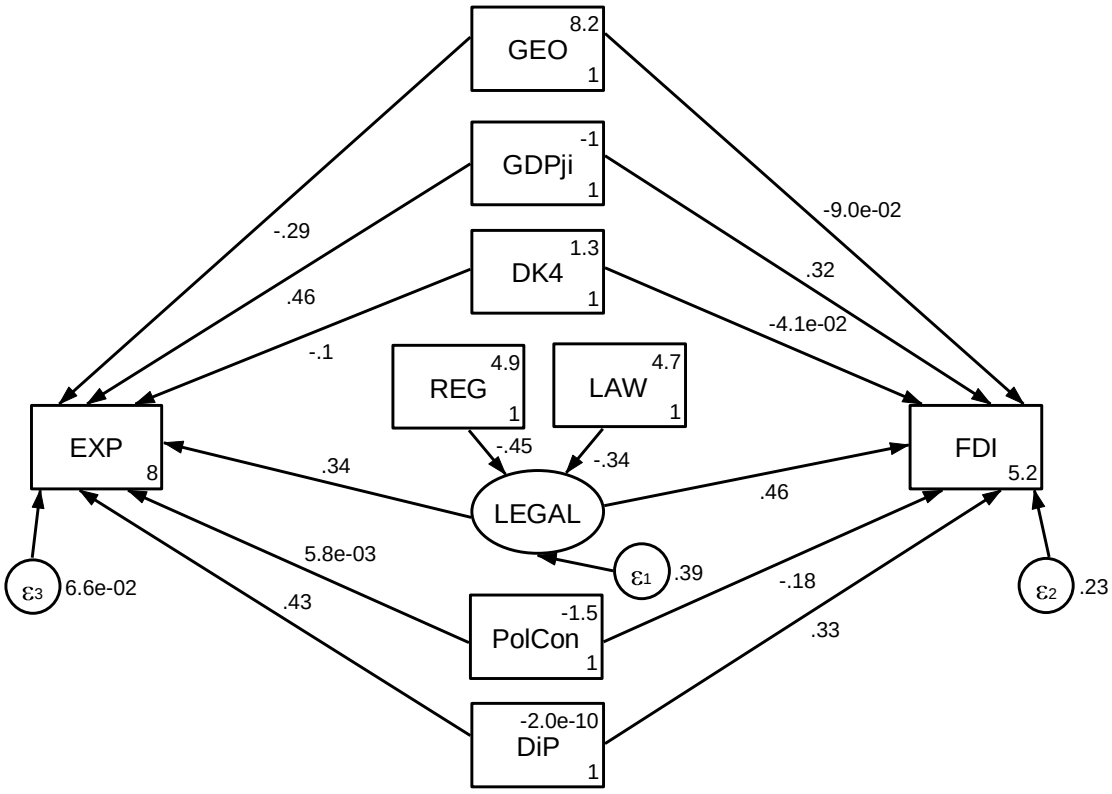
Zhou, K. & Poppo, L. 2010. Exchange hazards, relational reliability, and contracts in China: The contingent role of legal enforceability. *Journal of International Business Studies*, 41: 861–881.

Zhou, K., Poppo, L. &, Zhilin, Z. Y. 2008. Relational Ties or Customized Contracts? An Examination of Alternative Governance Choices in China. *Journal of International Business Studies*, 39: 526-534.

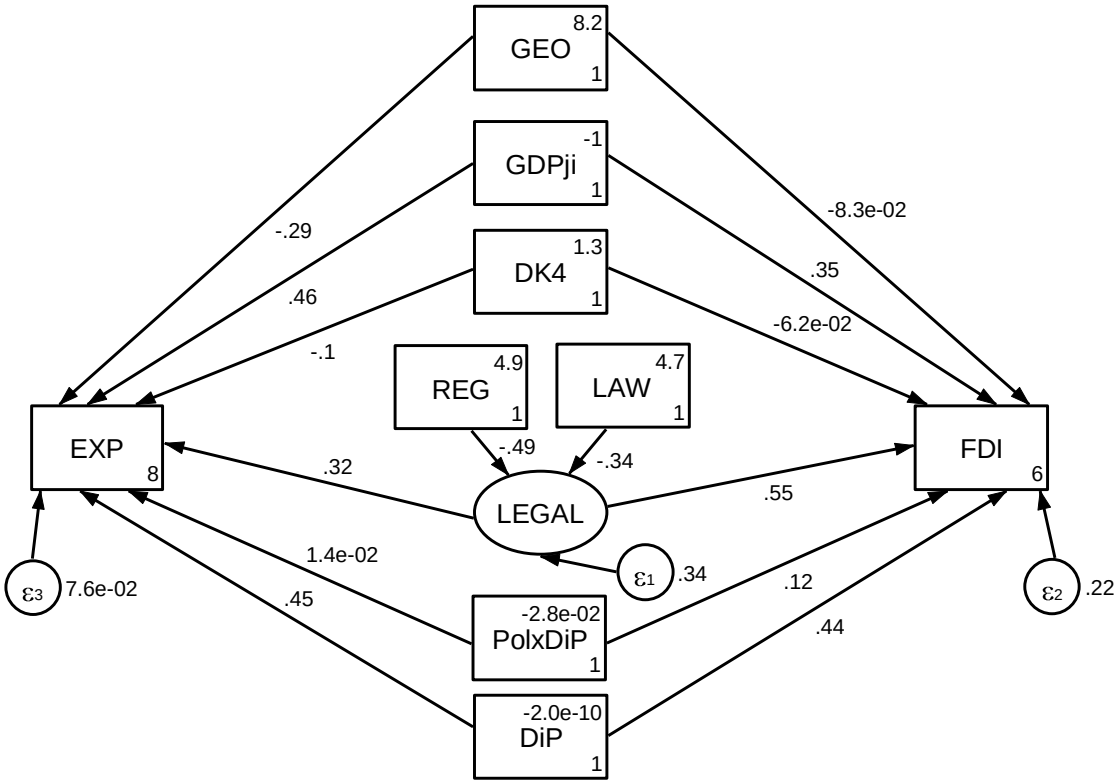
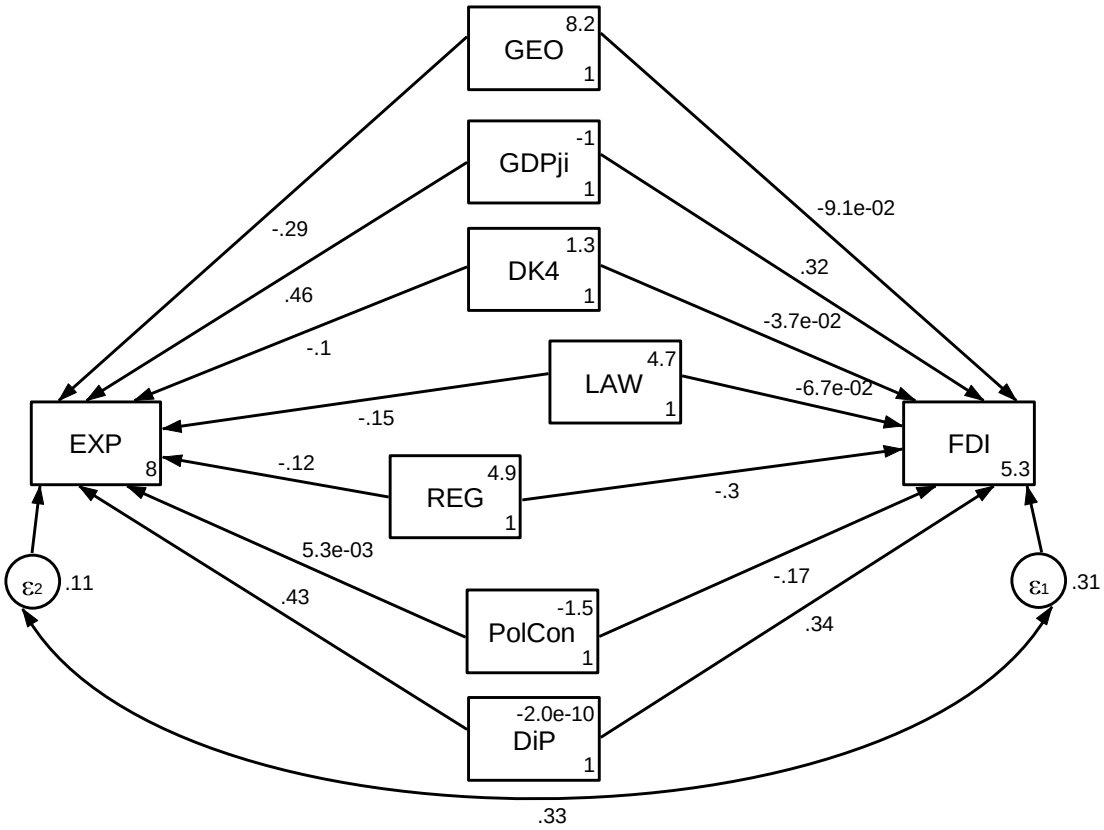
Zucker, L. 1983. Organizations as institutions. In Bacharach, S. (ed.*), Research in the Sociology of Organizations*. Greenwich, CT: JAI Press.

ANEXXES

MODEL (1)



MODEL (2)



PATH ANALYSIS