

# **INSTITUTIONAL BARRIER, LEARNING THROUGH EXPERIENCE AND NETWORK TIES, AND FDI LOCATION CHOICE OF EMNES\***

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### **ABSTRACT**

What organizational learning mechanisms matter particularly in the relationship between institutional barriers and FDI location choice in emerging multinational enterprises (EMNEs)? To answer this question, this study examines the impact of both formal and informal institutional barriers on the location choice of EMNEs, and the moderating effect of organizational learning on the above focal relation. We argue that EMNEs can leverage organizational learning to facilitate their international market entry; however, there exist different kinds of organizational learning mechanisms and they matter in different ways. For example, organizational learning can be at least two types: experiential learning and network learning. We proposed hypotheses on how the above two types of learning shape the effect of two types of institutional barriers on entry location. These hypotheses are tested via a dataset we collect from Chinese public-listed manufacturing companies. Empirical results indicate that EMNEs prefer countries with proximate culture and with less formal institutional risk. Moreover, we find a strong impact from experiential learning (learning from FDI experience) than network learning (learning from alliance networks). Importantly, firms with higher level of FDI experience are more likely to enter countries with both higher formal and informal institutional barrier; while firms with higher level alliance network tie with foreign partners are only more likely to choose countries with more risky formal institution. Implications, limitations and future research directions are addressed.

**Key words:** Cultural distance, Formal institutional risk, Location choice, Experiential learning, Network learning

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## INTRODUCTION

The past two decades have witnessed a vigorous rising of MNCs from emerging markets. Their aggressive outward foreign direct investment has been depicted as a “fever” and even incurs “fear” to Western countries (He & Lyles, 2008). Particularly, the largest emerging economy, China has conducted a remarkable outward direct investment as high as \$124 billion, second to United States (UNCTAD, 2013). Therefore, “emerging giants” from those countries become a focus of media, international policy, multinationals report and also the scholars in international business field (Khanna & Palepu, 2006). Studies on Emerging economies MNCs (EMNEs) have been published increasingly on main stream journals (Peng, 2005).

As later comers in the global arena, the internationalizing rational and motives, behaviors and activities of EMNEs are different from the first movers from developed economies (Li, 2007; Luo & Tung, 2007). Their lack of ownership advantages, eager for strategic-assets, salient mergers and acquisitions, radical internationalization process challenge the conventional wisdom of previous literature on mature markets MNCs (Gammeltoft, Barnard & Madhok, 2010; Rugman, 2007; Yiu, Lau & Bruton, 2007). Scholars are thus suggested to be cautious when they attempt to explain the behavior of EMNEs while applying findings derived from MNCs from advanced economies (Child & Rodrigues, 2005; Luo & Tung, 2007). In contrast, theoretical arguments and empirical tests are encouraged to illuminate the unknown pattern underlying the distinctive internationalization of EMNEs (Buckley *et al.*, 2007; Boisot & Meyer, 2008; Sun *et al.*, 2010).

This paper addresses the FDI location choice issue of EMNEs, one of the major concerns of international business researchers and multinational managers (Buckley, Devinney & Louviere, 2007). Based on different theoretical perspectives, anecdotal evidence provides valuable insights on this issue. One stream of them identified the locational advantages of host countries attracted FDI of EMNEs drawing from Dunning’s OLI paradigm (Buckley *et al.*, 2007; Cheung & Qian, 2009). Another important stream of these studies highlighted the formal and informal institutional factors in shaping perceived uncertainty specific to host countries (Kang & Jiang, 2012; Quer, Claver & Rienda, 2012).

Despite their contribution, researches on EMNEs remain at an infant stage (Yiu, Lau & Bruton, 2007). Some gaps remain to systemically understand the location strategy of EMNEs. For example, through institutional lens, recent empirical studies provide inconsistent results. The effect of cultural difference and informal institutional risks on location choice is found to be significant or nonsignificant (Duanmu & Guney, 2009; Quer, Claver & Rienda, 2012; Kang & Jiang, 2012). More empirical testing therefore is needed to build consensus on this complex relationship (Quer, Claver & Rienda, 2012). Our study is firstly designed to reconcile this inconsistency using our FDI data from Chinese firms.

Particularly, firm heterogeneity is suggested to be explored to explain the different pattern demonstrated in previous studies (Duanmu, 2012). While, firm level attributes obtained little consideration, except for several but important studies (Duanmu, 2012; Ramasamy, Yeung & Laforet, 2012). They introduced ownership variable to distinguish the different sensitivity to

institutional factors of SOEs and private firms. Nonetheless, a systematic investigation on the relation of firm level characteristics and EMNEs' response to institutional uncertainty is missing so far. This is the second and a more salient research gap our study attempt to fill.

To extend on this line of research, the present study introduces the firm heterogeneity in terms of organizational learning into location choice literature on EMNEs. Built on the behavioral theory of the firm (Cyert and March, 1963), researchers in international business suggest that firms could learn to internationalize (Nadolska & Barkema, 2007). For example, multinationals could learn to improve performance of foreign subsidiaries (Barkema, Bell & Pennings, 1996), learn to increase the likelihood of cross border M&A (Nadolska & Barkema, 2007) and also learn to choose beneficial mode and location strategy (Belderbos, 2003).

Through the learning lens, location choice decision is not purely costs calculating based on the location advantages and institutional deterrence, but also affected by the learning behavior of multinational enterprises (Buckley, Devinney & Louviere, 2007). Specifically, firms could learn to internationalize from their own experience and from others (Levitt & March, 1988). We thus attempt to investigate how the FDI experience and network tie of EMNEs facilitate them to overcome institutional entry barriers of host countries.

Both of the experiential learning and network learning approach inject insights to literature on EMNEs. First, experiential knowledge is regarded as an important driving force of internationalization in traditional literature (Johanson & Vahlne, 1977). The accelerated international expansion of EMNEs, while, challenges this argument (Gammeltoft, Barnard & Madhok, 2010). The importance of experience in the internationalization process of EMNEs remains largely unarticulated (Luo & Tung, 2007). We will unprecedentedly provide empirical evidence on how experience set the tone of the aggressive FDI of EMNEs.

Second, firms in emerging economies are born in a highly internationalized network which is different from the first movers from mature markets (Luo & Tung, 2007), which provide a fertile field for network approach on internationalization (Yiu, Lau & Bruton, 2007). For example, Chinese firms are exposed to an internationalized network since China has been one of the most attractive investment destinations, and its inward FDI stock has reached 711,802 million dollars in 2011 (UNCATD, 2013). How these network advantages promote EMNEs to go global will be demonstrated in their location choice as well in our study.

In summary, to advance the understandings on the internationalization on EMNEs, we ground our arguments on institutional theory, experiential learning and network learning approach (Johanson & Vahlne, 1977; Johanson & Vahlne, 2009; Xu and Shenkar, 2002), and focus on two research questions: (1) how do formal and informal institutional barriers impact the location strategy of EMNEs? (2) How do firms learn to bridge the institutional barriers through experience and network ties? By answering the two questions, we incorporate the influence of both country level and firm level attributes on EMNEs' foreign market selection strategy.

Our empirical background is the foreign direct investment (FDI) of Chinese firms. In recent years, China has become in the limelight of emerging economies literature owing to its growing FDI (Ramasmay, Yeung & Laforet, 2012). Different from many studies using country level aggregated data (Buckley *et al.*, 2008; Cheung & Qian, 2009; Kang & Jiang, 2012), our results are based on firm level FDI data of Chinese listed firms. Thus we can provide a micro level FDI location profile and also probe into the specific internationalizing

behavior.

The remainder of this paper is organized as follows. In the next section, we give a review on past literature relevant to our study. Then hypotheses are proposed to deliver our major argument. After describing our method and data, empirical results for testing our hypotheses are given. We conclude and discuss our results to illumine our contributions and limitations.

## BACKGROUND LITERATURE

Institutional factors have long been identified as important determinants of internationalization location choice (Dunning, 1980; Dunning, 1997). The cultural, political, economic, social and regular institution of host countries could incur liability of foreignness and thus deter foreign market entry (Zaheer, 1995). It is exemplified in many studies on advanced MNCs that firms prefer cultural similar and less institutionally risky countries when making FDI location choice (Benito & Gripsrud, 1992; Chen & Chen, 1998; Flores & Aguilera, 2007; Galan, González-Benito & Zuñiga-Vincente, 2007; Mariotti & Piscitello, 1995).

Recent empirical studies provide some evidence on institutional influences on location choice by emerging economies firms (Duanmu, 2012; Kang & Jiang, 2012; Quer, Claver & Rienda, 2012). Most studies indicated the attractiveness of proximate culture and less risky political institution (see, Buckley *et al.*, 2007; Cheung & Qian, 2009; Duanmu & Guney, 2009; Ramasamy, Yeung & Laforet, 2012). Their sample data both come from country level and firm level. For example, Buckley *et al.* (2007) used the official Chinese FDI data between 1984 and 2001. Duanmu & Guney (2009) included both Chinese (1999-2002) and Indian (2001-2004) FDI data into their analysis. And Ramasamy, Yeung & Laforet (2012) provide firm level evidence by collecting data from 63 Chinese multinationals in 2006-2008.

However, some studies provided a nonsignificant relation between institutional factors and location choice meanwhile (Duanmu, 2012; Kang & Jiang, 2012; Quer, Claver & Rienda, 2012). For instance, empirical results of Kang & Jiang (2012) did not found a strong relation between cultural distance and Chinese FDI to East and Southeast Asia of 1995 to 2007. As regards firm level data, Duanmu (2012) analyzed the investment data from 189 Chinese firms, but found no support to the relation between economic institution and location choice. Notably, Quer, Claver & Rienda (2012) showed neither cultural distance nor political risks have impact on location choice of large Chinese firms.

These inconsistent results should be interpreted carefully, given their different research level, sample and measurement of institutional factors. They provide us with an overall pattern that institutional barriers exist for Chinese firms as for mature MNCs (Buckley *et al.*, 2007; Cheung & Qian, 2009; Duanmu & Guney, 2009; Ramasamy, Yeung & Laforet, 2012). However, the deterrence effect of institutional barriers might be contingent on the specific attributes of host countries and firms (Duanmu, 2012; Kang & Jiang, 2012; Quer, Claver & Rienda, 2012). Particularly, attention on firm heterogeneity is recommended to have a better understanding on how firms differ in response to institutional entry barriers (Xu & Shenkar, 2002).

Nonetheless, ownership is the only firm level variable considered by previous empirical studies on the institutional determinants and location choice of EMNEs (Duanmu, 2012; Ramasamy, Yeung & Laforet, 2012). These two studies almost simultaneously suggested that

Chinese private firms are more averse to political risk than SOEs. Given their insightful contribution, we still know little about how other important resource, strategic, structural and behavioral attributes of EMNEs differentiate their location strategy from other multinationals (Xu & Shenkar, 2002). Especially, the learning effect in internationalization identified in anecdotal international business literature has been seldom examined in empirical studies on EMNEs (Nadolska & Barkema, 2007).

Previous studies concerning learning behavior of MNCs can be classified into two streams: learning from experience and learning through network relationship (Johanson & Vahlne, 1977; Johanson & Vahlne, 2009). Experiential learning is recognized as one of the most important ways of learning in the process of international expansion (Gaur & Lu, 2007; Luo & Peng, 1999). So this perspective has been adopted in location choice literature early and widely, represented by the Uppsala Model (Johanson & Vahlne, 1977; Benito & Gripsrud, 1992; Davidson, 1980; Erramilli, 1991). These studies suggest that international experiences facilitate firms' entry into countries with higher institutional barriers (Eriksson *et al.*, 1997). Given the same cultural distance and formal institutional risk, the attractiveness of specific country varied from the knowledge level of firms (Benito & Gripsrud, 1992; Erramilli, 1991).

Learning by doing is an important way of organizational learning, yet, is not the only way. The complex learning pattern of internationalization is beyond experience (Johanson & Vahlne, 2009). Network approach provides authors in international business field with another perspective of learning in global background. Their major argument is that firms could obtain international knowledge through interaction with network members (Coviello & Munro, 1995; Elango & Pattnaik, 2007). Firms positioned in international network could acquire necessary knowledge for internationalization, notably knowledge pertain to foreign market entry, subsidiary operation and management (Ojala, 2008).

Network approach attracted a growing interest in the past decade (Johanson, & Vahlne, 2003; Johanson & Vahlne, 2009; Sharma & Blomstermo, 2003), especially because the rising of less experienced MNCs in global market challenges the assumption of incremental process represented in Uppsala Model (Johanson & Vahlne, 1977). Johanson & Vahlne (2009) even revised their initial Uppsala model stated in the seminal paper of 1977 to incorporate the network theory into their arguments on the international learning process. More and more scholars have been applied the network approach to the internationalization of multinationals without rich experience, such as SMEs (Chetty & Holm, 2000; Zhou, Wu & Luo, 2007), Born Globals (Coviello & Munro, 1995; Coviello & Munro, 1997; Sharma and Blomstermo, 2003), emerging economies MNCs (Yiu, Lau & Bruton, 2007; Elango & Pattnaik, 2007) and so on.

Despite the popularity of these two learning perspective in previous studies (Barkema, Bell & Pennings, 1996; Luo & Peng, 1999; Nadolska & Barkema, 2007), empirical studies on effect of two ways of learning on the foreign market entry of EMNEs remain insufficient (Elango & Pattnaik, 2007). Hence, a systemic investigation on how EMNEs learn to locate themselves in countries with higher institutional barriers is missing so far. This research void inform this study to explore the learning mechanism of EMNEs pertain to overcoming the institutional barriers.

## HYPOTHESES

### The effect of formal and informal institutional barriers

Previous studies suggested that institution build barriers for foreign market entry in two ways (Peng, Wang & Jiang, 2008). In an informal way, cultural difference between host and home country incur additional costs of foreign firms (Barkema, Bell & Pennings, 1996; Kogut & Singh, 1988). And in a formal way, underdeveloped political, economic and regular institutional arrangement of host countries increases risks for MNCs (Chan, Isobe & Makino, 2008; Bevan, Estrin & Meyer, 2004). Both ways will be discussed to develop our hypotheses.

Based on institutional theory, national culture underpins the institutional context of the society (Peng, Wang & Jiang, 2008). By normalizing what should be done, culture shapes the legitimate social and business activities in specific environment (Xu and Shenkar, 2002). Different culture is shown to result in different organizational practices and employee expectations in international business literature (Kogut & Singh, 1988). International business scholars term the difference between national cultural system as “cultural distance” (Brouthers, 2002). It is suggested cultural distance could cause more transaction costs for MNCs both internally and externally (Barkema, Bell & Pennings, 1996).

A large body of evidence showed cultural difference is likely to increase costs of internal communication (Bhagat *et al.*, 2002; Brouthers, 2002). Since communicating activities are more complex under different paradigm, efficiency of information exchange will be lowered when across different culture (Bhagat *et al.*, 2002). Previous studies highlighted the communication barriers prevent parent companies from transferring firm specific advantage to foreign subsidiaries (Erramilli, 1991). Espicillay, tacit routines and knowledge necessary for internationalization are more difficult to disseminate within MNCs (Zaheer, 1995).

As for interacting with external partners, cultural distance incurs additional costs by eroding their mutual understanding (Eden & Miller, 2004). Foreign firms will find themselves facing challenges in identifying and interpreting unfamiliar business climate (Zaheer, 1995). It is costly and even takes years for foreign firms to adapt to different cultural patterns (Zaheer, 1995). Moreover, foreign firms might be misunderstood by native actors, due to their divergence in terms of the societal expectations. Therefore, mutual trust could be darken because the conflict of the social norms (Xu & Shenkar, 2002).

The more culturally different between home and host countries, the higher transaction costs and perceived uncertainty incurred to multinationals (Brouthers, 2002). Both from a research perspective or a managerial point of view, decision regarding the destination of internationalization could not be made without examining the cultural difference (Tihanyi, Griffith & Russell, 2005). Existing literature have supported the MNCs’ propensity to similar cultural patterns when invest in foreign market (Davidson, 1980; Benito & Gripsrud, 1992). Even with the accelerated global integration and cultural globalization, culture still has significant effect on the location choice of MNCs (Flores & Aguilera, 2007). Studies concerning emerging market also indicated that the cultural proximity attracts FDI from the Chinese MNCs (Buckley *et al.*, 2007; Morck, Yeung & Zhao, 2008). Therefore, we propose:

*H1a: EMNEs are more likely to enter culturally closer countries to conduct FDI.*

Formal institution is also highlighted to influence the practices of multinationals in

international business literature (Delios & Henisz, 2003; Ionascu, Meyer & Erstin, 2004; Peng, Wang & Jiang, 2008; Schwens, Eiche & Kabst, 2011). Formal institution set up the “rule of the game” in a regular way, by defining what have to be done (North, 1990). Together with the cultural system, formal institution builds the overarching institutional framework affecting economic activities (Peng, Wang & Jiang, 2008). This study follows the suggestion of Bae & Salomon (2010), defining the formal institution into two dimensions: political dimension and economic dimension. Political and economic regimes govern the social and business activities more explicitly than national culture (Peng, Wang & Jiang, 2008). Scholars suggested that the formal institutional risk has a direct influence on operating efficiency of multinationals (Chan, Isobe & Makino, 2008).

Risks of political institution refer to the policy creditability and policy volatility (Delios & Henisz, 2003). If the government could commit to the enforcement of the law and contracts, firms would like to make commitment to this market (Bae & Salomon, 2010). In contrast, firms avoid investment in countries with widespread corruption and lack of legal enforcement, because low political effectiveness raise the operation costs and increase the hurdle of return (Chan, Isobe & Makino, 2008). Except for the low policy creditability, unexpected policy changes also could take a toll on multinationals (Delios & Henisz, 2003). A less stable political regime would provide less certain investment return.

Economic institution is another important leg which underpins the formal institutional framework (Peng, Wang & Jiang, 2008). Market orientation, economic structure and economic liberality construct the economic environment (Bae & Salomon, 2010; Salomon & Wu, 2010). Similar with the political institution, national economic formal arrangements provide distinctive incentives and put constraints for corporate operation (Jackson & Deeg, 2008). Countries with sufficient economic freedom and low economic risk are more attractive for foreign investment (Bevan, Estrin & Meyer, 2004; Ionascu, Meyer, & Erstin, 2004).

As a result, firms prefer countries with lower formal institutional risk, where they will face less political and economic hazard (Bevan, Estrin & Meyer, 2004). For MNCs from emerging countries which are characterized with lower institutional development, like China, institutional constraints in home land push more motives for firms to invest in more developed countries (Luo & Tung, 2007). It is known as “institutional escape” or “institutional arbitrage” in previous literature, that emerging EMNEs choose FDI as a legal strategic option to avoid institutional voids in home country (Boisot & Meyer, 2008; Witt & Lewin, 2007). They might move abroad to seek for intellectual property protection and perfect market which could not be obtained at home (Child & Rodrigues, 2005). Based on these arguments, EMNEs are more likely to choose countries with more perfect formal institution as FDI destination. We propose:

*H1b: EMNEs are more likely to enter countries with less formal institutional risk to conduct FDI.*

## The moderating effect of organizational Learning

Previous studies indicated that organizational learning is conducive to lessen both the formal and informal institutional barrier (Barkema, Bell & Pennings, 1996; Luo & Peng, 1999.). Anchored on organizational theory, we argue that EMNEs could learn both from “direct experience” and from “experience of others” (Levitt and March, 1988: 319). Therefore we specify two learning mechanism of EMNEs, experiential learning and network learning to



embody “direct experience” and “experience of others” respectively. Their moderating effect on the relation between institutional barriers and location choice would be discussed next.

### **The moderating effect of experiential learning**

Experiential learning is emphasized as a necessity for international expansion because they weave knowledge into repertoires of MNCs (Nadolska & Barkema, 2007). Levitt and March (1988) suggest that learning from experience involves encoding inference from history into knowledge that could buttress and guide future behavior. From past international practice, firms retain knowledge about how to internationalize in the future (Chang, 1995). Herein we highlight the knowledge pertain to the informal and formal institutions of host countries, and how these knowledge facilitate EMNEs expand to culturally distant and formal institutionally risky countries (Eriksson *et al.*, 1997).

Previous studies suggested that cultural barrier diminish when multinationals become experienced over time (Barkema, Bell & Pennings, 1996; Holburn & Zelner, 2010). Johanson & Vahlne (1977) found this pattern early and develop an incremental stage model of internationalization. A key insight of their model is that MNCs expand to more psychically distant market as they gradually learn more about foreign market from experience (Johanson & Vahlne, 1977; Eriksson *et al.*, 1997). Subsequent studies provide more empirical support to fortify this insight (Davidson, 1980; Delios & Henisz, 2003; Erramilli, 1991).

Within the experiential learning framework, knowledge captured by firms is somehow routine-based and history-dependent (Levitt and March, 1988). Experiential knowledge is therefore different from lessons obtained from indirect experience which is not relied on history (Johanson & Vahlne, 1977). For example, firms could learn the difference of language, education and business practices between home and host country by directly operating abroad (i.e. experiential knowledge) and indirectly market research (i.e. general knowledge) (Eriksson *et al.*, 1997). Obviously, path-dependent experiential knowledge is costly than general knowledge, hence more valuable by nature (Levitt & March, 1988). In the process of internationalization, costly experiences endow firms with more information and capability to commit further to foreign market (Nordstrom & Vahlne, 1992).

Therefore, firms with little FDI experience will be less knowledgeable about global culture and more capable to cope with the additional transaction costs incurred by cultural distance (Davidson, 1980; Erramilli, 1991). They tend to overestimate the potential investment risk and choose culturally similar FDI destinations (Agarwal & Ramaswami, 1992). In contrast, experienced firms are more likely to overcome the cultural barriers, because they are more learned to know how legitimate themselves in different cultural context (Erramilli, 1991). The Uppsala model even highlighted the irreplaceability of experiential knowledge (Eriksson *et al.*, 1997).

As for the accelerated international expansion of EMNEs, empirical studies provide limited sights on how they capture reference from their FDI experience. However, as Luo & Tung (2007) articulated, EMNEs “do not necessarily follow the incremental approach in internationalization, they still attend carefully to the importance of organizational learning and global experience” (Luo & Tung, 2007, p. 482). Based on these studies, we argue that experienced EMNEs would perceive less uncertainty given the cultural distance than inexperienced ones. Therefore we propose:

*H2a: EMNEs' FDI experience will positively moderate the relationship between cultural distance and location choice. Specifically, firms with higher level FDI experience will be more likely to enter countries culturally farer than firms with lower level FDI experience.*

International experience also mitigates the formal institutional risk, similar as its uncertainty reduction role in the cultural context (Delios & Henisz, 2003). Prior FDI experience facilitates firms in learning about the political and economic policies and even to predict policy change (Henisz & Macher, 2004). Experienced firms will suffer less from the incomplete and under-developed formal institutional constraints than those inexperienced ones, because they know more about the hazards (Schwens, Eiche & Kabst, 2011). For example, the spread of corruption is considered more costly than economic tax for firms (Chan, Isobe & Makino, 2008). International experience will equip multinationals with information and knowledge about how corruption influences business activities, then more prepared to entry host countries with lower corruption.

Except for the information accumulating role in international learning process, experience plays a more important role of capability building (Holburn & Zelner, 2010). Experience not only helps firms to know the institutional hazard, but also prevent firm from formal institutional underdevelopment by capability shaping (Johanson & Vahlne, 1977). Organizational learning theory suggests that direct experience change organizational routines (Levitt & March, 1988). While, routine-based firm specific advantages are regarded as important capacity to overcome liability of foreignness (Zaheer, 1995). For example, experienced firms are more capable to better allocate resources to minimize the negative effect of political transparency (Delios & Henisz, 2003). Sometimes, firms with more political capability could even exert influence on formal institution of host countries. For instance, foreign firms could lobby government for favorable labor laws to protect them from restriction by labor regulations (Holburn & Zelner, 2010).

Based on above arguments, firms with more FDI experience would understand, predict and even manipulate formal institution of host countries better (Henisz & Macher, 2004; Holburn & Zelner, 2010). So FDI experience would shrink the difficulties in mounting successful investment, especially to high political and economic hazards settings (Holburn & Zelner, 2010). Given other location advantages, such as potential market, low production costs, and sophisticated technology, the experienced EMNEs could choose less perfect formal institution more likely. In contrast, inexperienced ones might be more inclined to eschew. Herein we propose:

*H2b: EMNEs' FDI experience will positively moderate the relationship between formal institutional risk and location choice. Specifically, firms with higher level FDI experience will be more likely to enter countries with higher formal institutional risk than firms with lower level FDI experience.*

### **The moderating effect of network learning**

Network theory suggested that resource acquiring and capability building process are embedded in the interaction with actors within the network (Granovetter, 1992). Based on this perspective, scholars in international business elaborated a network approach on internationalization (Johanson & Vahlne, 2003; Johanson & Vahlne, 2009). They suggests that compared with firms in domestic network, those operating in international network enjoy a "learning advantages" by information and knowledge exchange through network ties

(Sharma & Blomstermo, 2003). Firms without relevant international network relationship are termed “outsiders”, and suffer from the “liability of outsidership” due to lack of knowledge supplied by network ties (Johanson & Vahlne, 2009).

Valuable network ties might be formal and informal (Yiu, Lau & Bruton, 2007), direct and indirect (Coviello & Munro, 1997; Ojala, 2009), strong or weak (Sharma & Blomstermo, 2003), firm-level or individual-level (Ellis, 2000). They all provide critical knowledge and drive the foreign market entry of multinationals. Notably, previous studies highlighted that these international network ties are not necessarily built in foreign market geographically (Sharma & Blomstermo). Firms operated in domestic market could also engage in international network by establishing relationship with other foreign counterparts (Luo & Tung, 2007).

Compared with MNCs from mature economies, EMNEs are born in a highly internationalized network even just operated in geographically domestic market (Johanson & Mattsson, 1988). They might have been engaged the global industrial value chain before they conduct any export business and foreign direct investment (Luo & Tung, 2007). For example, many EMNEs have been OEMs, ODMs, suppliers and joint venture partners of foreign MNCs in homeland (Luo & Tung, 2007). Based on the network learning approach, all those network linkage of EMNEs can serve as knowledge tunnel.

In this study, we focus on one of these international network ties, the international joint venture linkage between EMNEs and their foreign partners in home country. Literature on alliance implied that joint venture provides access to partners’ skills, competencies and their knowledge about foreign environment (Kale & Singh, 2007; Tsang, 2002). For EMNEs with less international experience, alliance with foreign multinationals could be a platform for acquiring requisite information and knowledge for internationalize (Elango & Pattnaik, 2007).

As for the cultural barrier of foreign market entry, firms with international alliance network ties would have more confidence to overcome the difficulties of cultural adaption (Ojala, 2009). They are more familiar with and also more capable to overcome the cultural difference during interaction with their foreign partners. So we propose:

*H3a: EMNEs’ international joint venture network tie will positively moderate the relationship between cultural distance and location choice. Specifically, firms with higher level joint venture network tie will be more likely to enter countries culturally farther than firms with lower level joint venture network tie.*

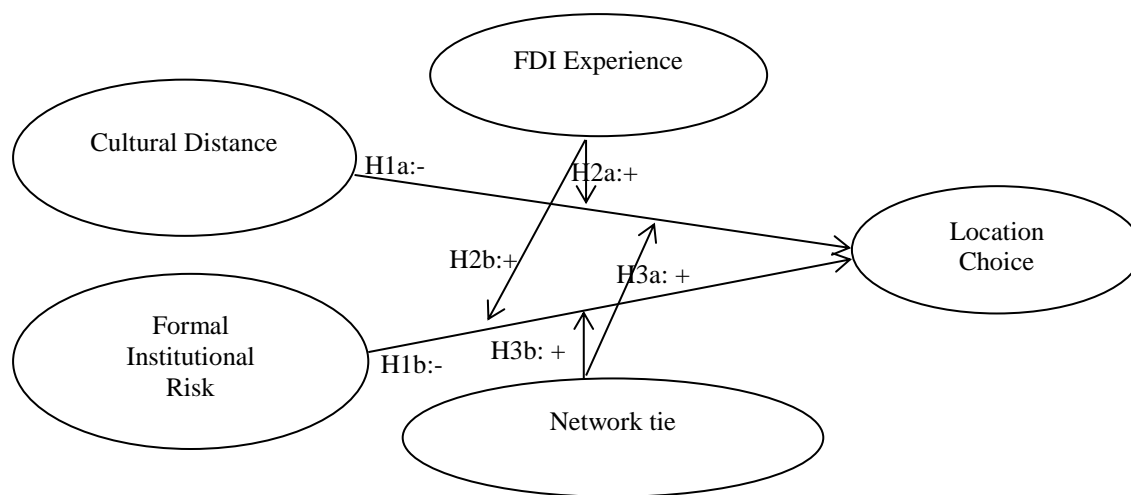
Similarly, formal institutional knowledge could also be transferred thorough network linkage (Johanson & Vahlne, 2003; Johanson & Vahlne, 2009). Past studies proposed that firms positioned in international network could learn from partners how to successfully compete in different institutional environment and cope with the formal institutional uncertainty in host countries (Hadley & Wilson, 2003).

As aforementioned, less developed institutional environment provide economic activities with lower munificence (Yiu, Lau & Bruton, 2007). Firms have to allocate more resource to overcome the institutional voids, thus operating less efficiently (Gaur & Lu, 2007). Also, it is more difficult to identify the legitimate behavior in unstable political and economic institutional structure, thus making decision less effectively (Chan, Isobe & Makino, 2008).

These unfavorable effects might be mitigated when firms get more knowledgeable and insusceptible. Joint venture tie between EMNEs and experienced foreign firms could be a source of valuable institutional knowledge (Luo & Tung, 2007). So, firms with joint venture linkage are more likely to handle the formal institutional barrier. Therefore, we propose:

*H3b: EMNEs' international joint venture network tie will positively moderate the relationship between formal institutional risk and location choice. Specifically, firms with joint venture network tie will be more likely to enter countries with less developed formal institution than firms without joint venture network tie.*

Figure 1 depicts the conceptual framework capturing the important hypotheses proposed above.



**Figure 1.** Conceptual framework

## METHOD

### Data

To test our hypotheses, the empirical analysis is implemented based on data collecting from Chinese public firms on Shanghai Stock Exchange (SHSE) and Shenzhen Stock Exchange (SZSE). We select firms in manufacturing industry (according to the industry classification standard of China Securities Regulatory Commission), since the number of firms conducted FDI in manufacturing industry is larger than any other industry in recent years, according to the Statistics Bulletin of China's Outward Foreign Direct Investment published yearly<sup>2</sup>. For example, the bulletin reported that firms engage in FDI in manufacturing industry accounts for the 33%, 31.8%, 31.3%, 30.2% and 35.8% of the total number of investors from 2006 to 2010 respectively. In addition, manufacturing industry has been chosen as sample in a large

<sup>2</sup> Statistics Bulletin of China's Outward Foreign Direct Investment is published yearly by Ministry of Commerce (MOC), National Bureau of Statistics (NBS), and State Administration of Foreign Exchange (SAFE) of People's Republic of China.

body studies on FDI location choice of MNCs from developed countries (Cheng, 2007; Du, Lu & Tao, 2008; Filatotchev *et al.*, 2007; Henisz & Delios, 2001; Nachum & Wymbs, 2005; Yamawaki, 2006; Friedman, Gerlowski & Silberman, 2006). So it is reasonable to compare our results with their findings.

We first scrutinized the annual financial report of each manufacturing firm on SHSE and SZSE, to pick out those conducted FDI in 2006 to 2010. Following previous FDI location research on Chinese listed firms (Ramasamy, Yeung & Laforet, 2012; Yuan & Pangarkar, 2010), if the firm set up any new foreign subsidiaries or engage in overseas acquisitions, we define the firm is conducting FDI. We included FDI to Hong Kong, Taiwan and Macao in our sample. However, tax havens are excluded from the final sample, such as the British Virgin Islands, the Cayman Islands, and the Bermuda Islands. The number of FDI firms in 2006 to 2010 is listed in Table 1.

Second, we identified each FDI entry of the final sample firms in 5 observation years. Because firms may have invested into two or more foreign countries each year, our analysis would be based on FDI activity level. We treated each subsidiary setting or acquisition as an independent entry. The total number of FDI entries from 2006 to 2010 is 352, conducted by 187 firms to 53 countries. There are finally  $352 \times 53 = 18656$  entry-country observations. Due to the missing data, the number of observation decreased to 7335 in our estimation model

**Table 1.** Sample description

| Year  | Manufacturing Firms | FDI Firms | FDI Activities | Countries |
|-------|---------------------|-----------|----------------|-----------|
| 2006  | 881                 | 27        | 33             | 19        |
| 2007  | 942                 | 27        | 59             | 18        |
| 2008  | 993                 | 55        | 79             | 29        |
| 2009  | 1044                | 44        | 73             | 29        |
| 2010  | 1285                | 87        | 108            | 36        |
| Total | 1285                | 187       | 352            | 53        |

## Variables

**Entry<sub>ixt</sub>**: Following previous studies on FDI location choice (see, Henisz & Delios, 2001; Flores & Aguilera, 2007; Galan *et al.*, 2007), we created dichotomous variable as dependent variable. The location choice of firm X in country i in the observation year t is captured by the dummy variable Entry<sub>ixt</sub>. Entry<sub>ixt</sub> equals 1 if the firm X conduct FDI in country i in year t, otherwise equals 0.

**Cultural distance<sup>3</sup>**: The Kogut and Singh index is the most widely adopted measurement of cultural distance in international business literature (Barkema, Bell & Pennings, 1996; Tihanyi, Griffith & Russell, 2005). This index is operationalized from 4 national cultural dimensions developed by Hofstede (1980): power distance, uncertainty avoidance, individualism/collectivism, and masculinity/femininity. As Kogut & Singh (1988) did, we

<sup>3</sup> Particularly, all the independent variables, moderating variables and control variables have a one-year lag, so the value in year t-1 is adopted.

measure the cultural distance (CD) between China and the FDI destination country using above four dimensions as follow:

$$CD_j = \sum_1^4 \{(I_{ij} - I_{ic})^2 / V_i\} / 4 \quad (1)$$

Where  $CD_j$  captures the cultural distance between China and the host country  $j$ ;  $I_{ij}$  represents the score of host country in dimension  $i$ ;  $I_{ic}$  represents the score of China in dimension  $i$ .

**Formal institutional Risk:** Following Bae & Salomon (2010), we use two dimensions to illustrate the institutional development of host country: political/regular and economic dimension. World Governance Indicators (WGI) from World Bank database and Economic Freedom Index (EFI) from The Heritage Foundation are used as proxy of political and economic institution respectively. The WGI and EFI have been used as formal institution proxy in other empirical research (Bae & Salomon, 2010; Chan, Isobe & Makino, 2008; Kang & Jiang, 2012).

In this study, we aim to investigate the influence of the overall formal institutional environment of host countries on location strategy of EMNEs rather than each individual dimension of the formal institution. So we conducted a principal components analysis to calculate the overall score of formal institutional development. Following the way of Chan, Isobe & Makino (2008), our principal components analysis is based on the varimax rotation method, using six items of WGI and the one item of EFI to reduce dimensions. These seven items significantly loaded to one factor, with the factor loadings range from 0.741 to 0.981. This common factor explained 85.98% of the total variance. So it is reasonable to use the common factor as the proxy of formal institutional risk. As the EFI and WGI refer to the development of formal institution, we finally take the reverse scores to build our formal institutional risk index.

**FDI experience:** This is a proxy measure for experiential learning. It measures past FDI activities before specific time (Benito and Gripsrud, 1992). In this study, we use two variables to measure if a firm has been conducted FDI before the observation year: (1) Length captures the total number of years since the firm going abroad; (2) Frequency captures the total FDI times before each focal year. The data is collected from the annual financial report of focal firms. All FDI activities before given observation year are examined.

**JV network tie:** This is a proxy measure for network learning. It measures the total number of joint venture of firms in local market. Herein, the joint venture means the firm forming equity alliance with foreign firms, and establishing subsidiaries jointly in Chinese mainland. This information is also coded from annual report of public firms. We also defined the joint venture with firms from Hong Kong, Taiwan and Macao as sino-foreign ventures, in line with that we regarded the investment to Hong Kong, Taiwan and Macao as FDI.

Following past studies, we control for other country-level locational factors affecting FDI location choice when testing hypotheses relating institutional factors and location choice: resource, labor cost, market size, technology, geographical distance and FDI inflow (Filatotchev *et al.*, 2007; Flores & Aguilera, 2007; Galan, González-Benito &

Zuñiga-Vincente, 2007; Mina, 2007; Nachum & Wymbs, 2005).<sup>4</sup>

**Resource:** We control for the natural resource endowment using the proxy of energy production (kiloton of oil equivalent) reported by World Bank World Development Indicators (WDI) database (Mina, 2007). We take its natural logarithm.

**Market size:** We also control for the market potential attracting firms to invest in specific country. Gross National Income is a widely used proxy for market size of host countries in location choice literature (Davidson, 1980; Chen, 1997). We use the source of GNI and annual growth of GDP data from WDI of World Bank.

**Technology:** Technology development is also highlighted in previous location studies (Woodward & Rolfe, 1993). In our study, technology capability of host countries is measured by natural logarithm of patent applications (residents) reported by WDI in the national level (Yamawaki, 2006).

**Geographical distance:** We measure the geographical distance between China and host countries as the physical distance between the capital city of host countries and the capital of China (Beijing) (Flores & Aguilera, 2007). The data is available from City Distance Calculator of geobyte.com.

**FDI inflow:** we also control the annual FDI inflow (weighted by GDP) of host countries to capture the general FDI attractiveness of focal country.

All above variables are listed in Appendix I to have a clear overview.

## Statistical analysis

To test our hypothesis, we use McFadden's conditional logit model which is a widely used mode in earlier foreign market selection literature (Du, Lu & Tao, 2008; Friedman, Gerlowski & Silberman, 1992; Head, Ries & Swenson, 1995; Hogenbirk & Narula, 2004; Nachum, Zaheer & Gross, 2008; Quer, Claver & Rienda, 2012). The McFadden's model is designed to estimate the human discrete choice behavior (McFadden, 1974). The model assumes that firm will select the most profitable one among the choice set. Firms thus make location choice based on the attributes of potential host countries to maximize their return. Profits for FDI decision  $i$  in location  $j$  are:

$$\pi_{ij} = \beta'_{ij}X_j + \varepsilon_{ij} \quad (2)$$

Where  $X_j$  is a vector of observable attributes for location  $j$ ,  $\beta'_{ij}$  is a vector of parameters to be estimated, and  $\varepsilon_{ij}$  is a random error term.

The profit maximizing choice mean that firms will choose the country with highest  $\pi$ .

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<sup>4</sup> We originally take labor cost as one of the control variables, but the missing data of wages from International Labour Organization (ILO) (Woodward & Rolfe, 1993) reduced the sample sized sharply, so the final regression did not conclude the wage variable.

Location  $j$  will be chosen only when the expected profit could get from  $j$  ( $\pi_{ij}$ ) exceed the expected profit from other potential location  $k$  ( $\pi_{ik}$ ). When the error terms ( $\varepsilon_{ij}$ ) are independently and identically distributed according to a Weibull distribution, the probability of a firm's FDI will be located in country  $j$  is given by the following expression:

$$P_{ij} = \frac{\exp(\beta X_j)}{\sum_1^k \exp(\beta X_k)} \quad (3)$$

Where  $k$  is the number of alternatives, and  $\beta$  will be estimated with maximum likelihood estimation. In our study, the number of alternatives ( $k$ ) of any location  $i$  will be 52 (53-1). We only consider these 52 countries have been chosen by sample firms in the 5 observation year as alternatives. According to previous studies, adding alternatives would not be chosen will have almost no effect on the conditional logit model results (Nachum, Zaheer & Gross, 2008). So other countries are not included in our model.

## Results

Table 2 shows the descriptive statistics of each variable and their bivariate correlations.

We test our hypotheses using conditional logit model stepwise, see Table 3. We start with a baseline model (Model 1), which included control variables. Main effect of cultural distance and formal institutional development is added in model 2. Model 3, Model 4 and Model 5 add the interactions. Two full models, Model 6 and Model 7 include all variables and interaction terms. We separate the interaction terms of length and frequency to avoid multicollinearity due to high correlation of these two variables.

In model 1, only GNI and GDP growth have a positive impact on the location choice. Turning to the hypothesis testing of H1 and H1b, the coefficients of cultural distance and formal institutional development are both significantly at  $p < 0.001$ , and the direction is negative, so H1a and H1b is supported. It suggests that cultural distance and formal institutional risk have negative impact on location choice.

In Model 3 and Model 4, consistent with our hypothesis of experiential learning effect on the location choice, the coefficients of two interaction terms of FDI experience and two institutional variables are both significant. The direction of interaction terms of length and two institutional variables are both positive ( $p < 0.001$ ) and the interaction terms of frequency are both positive ( $p < 0.01$ ). The result provide evidence that firms with higher level FDI experience would be more likely to choose countries with higher institutional barriers as investment destinations, so H2a and H2b are both supported.

Model 5 stated the learning effect of networking with foreign partners in homeland on foreign market selections. The interaction terms of JV network tie with formal institutional risk is significant at  $p < 0.05$  and negative, indicating firms with JV ties will be less sensitive to the formal institutional risks of host countries. H3b is thus supported by the result. However, interaction term of JV network tie with cultural distance did not show a significant positive relation with dependent variable. Our prediction in H3a is not strongly supported.

## Robustness Check

Before settling on the conclusion, we have a robustness check. First, following Yuan &



Pangarkar (2010), we estimated a multinomial logistic model, which is also used in other location choice empirical research (Filatotchev *et al.*, 2007). The regression result is reported in Appendix II. Main results in conditional logit model are supported in multinomial logistic model. Particularly, the moderating effect of FDI experience and JV network tie on the relation in multinomial logistic model is similar with the results in conditional logit model. We can make robust conclusions on these consistent results.

## DISCUSSION AND CONCLUSION

In this paper, we aim to make contribution to literature on the under-explored location choice pattern of emerging economies. We focus on two issues: (1) The influence of cultural distance and formal institutional development on Chinese firms' internationalization market selection; (2) How the experiential learning and network learning impact the sensitivity of firms to these institutional barriers.

The empirical results support our major theoretical hypotheses. It is suggested that cultural distance and risky formal institution of potential host countries have negative effect on the likelihood of being chosen as FDI destination. Firms prefer countries with more similar culture and well-established institution arrangement to conduct FDI. These findings are consistent with the results of previous studies on location choice by Chinese MNCs (Buckley *et al.*, 2008; Cheung & Qian, 2009; Duanmu, 2012; Duanmu & Guney, 2009; Kang & Jiang, 2012; Ramasamy, Yeung & Laforet, 2012). Conventional researches on firms from developed countries show a same location preference (Benito & Gripsrud, 1992; Chen & Chen, 1998; Delios & Henisz, 2003; Henisz & Delios, 2001; Flores & Aguilera, 2007). Particularly, different from well-developed institutional context, firms from emerging countries characterized by weak institutional efficiency might have the motivation to escape the institutional voids in home country (Boisot & Meyer, 2008; Luo & Tung, 2007).

Our second conclusion concerns the moderating effect of organizational learning. We find that relation between institutional factors and market entry is moderated by the FDI experience and joint venture tie with foreign firms of the focal firm. We can see that uncertainty perceived by firms varies with the knowledge they have been equipped by learning from themselves and their foreign partners.

Consistent with studies on MNCs from developed economies (Davidson, 1980; Delios & Henisz, 2003; Erramilli, 1991), our Chinese samples based evidence verified the effect of experiential learning on internationalization process. It is recognized that EMNEs have embarked on a more aggressive international expansion in scale and scope (Luo & Tung, 2007). They might enter institutionally unfamiliar and risky countries in the early stage of their international process (Gammeltoft, Barnard & Madhok, 2010). From our empirical findings, the bold internationalizing behavior in terms of location choice is also backed by experience.

**Table 2.** Descriptive statistics and correlations

| Variable                    | Mean   | S.D.  | Min    | Max    | 1         | 2         | 3         | 4         | 5         | 6         | 7         | 8        | 9       | 10       | 11       | 12 |
|-----------------------------|--------|-------|--------|--------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|----------|---------|----------|----------|----|
| 1 Entry                     | 0.024  | 0.154 | 0.000  | 1.000  | 1         |           |           |           |           |           |           |          |         |          |          |    |
| 2 Cultural Distance         | 2.369  | 1.328 | 0.145  | 5.088  | -0.067*** | 1         |           |           |           |           |           |          |         |          |          |    |
| 3 Formal Institutional Risk | 1.271  | 0.929 | 0.000  | 3.357  | -0.083*** | -0.603*** | 1         |           |           |           |           |          |         |          |          |    |
| 4 Resource                  | 10.388 | 2.266 | 3.208  | 14.347 | -0.068*** | 0.239***  | 0.244***  | 1         |           |           |           |          |         |          |          |    |
| 5 GNI                       | 26.818 | 1.344 | 24.090 | 30.298 | 0.080***  | 0.314***  | -0.242*** | 0.594***  | 1         |           |           |          |         |          |          |    |
| 6 GDP Growth                | 1.980  | 4.441 | -8.500 | 10.494 | 0.003***  | -0.378*** | 0.321***  | -0.048*** | -0.244*** | 1         |           |          |         |          |          |    |
| 7 Technology                | 7.640  | 2.038 | 3.091  | 12.816 | 0.035***  | 0.401***  | -0.288*** | 0.551***  | 0.866***  | -0.238*** | 1         |          |         |          |          |    |
| 8 Geography Distance        | 8.715  | 0.582 | 6.861  | 9.741  | -0.074*** | 0.414***  | -0.176*** | 0.203***  | 0.163***  | -0.198*** | -0.028*** | 1        |         |          |          |    |
| 9 FDI Inflow                | 0.078  | 0.105 | -0.255 | 0.721  | 0.040***  | -0.039**  | -0.053*   | -0.298*** | -0.281*** | 0.192***  | -0.280*** | 0.019*** | 1       |          |          |    |
| 10 Frequency                | 1.182  | 1.867 | 0.000  | 8.888  | -0.007    | 0.002     | -0.002    | -0.001    | 0.010     | 0.018     | 0.003     | 0.001    | 0.021*  | 1        |          |    |
| 11 Length                   | 0.973  | 1.174 | 0.000  | 4.899  | -0.007    | 0.001     | -0.001    | 0.000     | 0.002     | 0.027     | 0.001     | 0.000    | 0.013   | 0.794*** | 1        |    |
| 12 JV network tie           | 0.748  | 0.670 | 0.000  | 2.000  | -0.007    | 0.001     | -0.001    | 0.001     | 0.004     | 0.098     | 0.000     | 0.000    | 0.036** | 0.278**  | 0.319*** | 1  |

\* p<0.05; \*\* p<0.01; \*\*\* p<0.001

**Table 3.** Results of conditional logit model for location choice

| Variable                                   | Model 1    | Model 2    | Model 3    | Model 4    | Model 5    | Model 6   | Model 7    |
|--|------------|------------|------------|------------|------------|-----------|------------|
| Resource                                   | -0.246***  | 0.044      | 0.068      | 0.043      | 0.047      | 0.067     | 0.044      |
| GNI  | 1.901***   | 1.539***   | 1.518***   | 1.532***   | 1.537***   | 1.519***  | 1.532*     |
| GDP Growth                                 | 0.091***   | 0.059*     | 0.058*     | 0.063**    | 0.062*     | 0.060*    | 0.065***   |
| Technology                                 | -0.602***  | -0.555***  | -0.552***  | -0.538***  | -0.553***  | -0.551*** | -0.537***  |
| Geography Distance                         | -0.897***  | -0.864***  | -0.856***  | -0.852***  | -0.865***  | -0.856*** | -0.852***  |
| FDI Inflow                                 | 1.647**    | 1.593**    | 1.596**    | 1.587**    | 1.617*     | 1.608*    | 1.590*     |
| Cultural Distance                          |            | -0.482***  | -0.485***  | -0.470***  | -0.477***  | -0.483*** | -0.468***  |
| Formal Institutional Risk                  |            | -0.893***  | -0.916***  | -0.885***  | -0.899***  | -0.919*** | -0.886***  |
| Cultural Distance × Frequency              |            |            | 0.116***   |            |            | 0.110**   |            |
| Formal Institutional Risk × Frequency      |            |            | 0.203***   |            |            | 0.188***  |            |
| Cultural Distance × Length                 |            |            |            | 0.117**    |            |           | 0.103*     |
| Formal Institutional Risk × Length         |            |            |            | 0.293***   |            |           | 0.269***   |
| Cultural Distance × JV network tie         |            |            |            |            | 0.096      | 0.026     | 0.067      |
| Formal Institutional Risk × JV network tie |            |            |            |            | 0.257*     | 0.131     | 0.124      |
| Obs  | 13479      | 11794      | 11720      | 11424      | 11794      | 11720     | 11424      |
| Log likelihood                             | -953.25757 | -884.71176 | -866.28245 | -845.11299 | -880.87158 | -865.6043 | -844.11443 |
| LR chi <sup>2</sup> (5)                    | 514.70     | 528.61     | 551.03     | 535.59     | 536.29     | 552.38    | 537.59     |
| Prob > chi <sup>2</sup>                    | 0.0000     | 0.0000     | 0.0000     | 0.0000     | 0.0000     | 0.0000    | 0.0000     |
| Pseudo R <sup>2</sup>                      | 0.2126     | 0.2300     | 0.2413     | 0.2406     | 0.2334     | 0.2419    | 0.2415     |

†p<0.1; \*p<0.05; \*\*p<0.01; \*\*\* p<0.001

With regard to the joint venture network tie, we find a significant moderating impact on the relation between formal institutional risk and market entry. However, the moderating effect on the association of cultural distance and location choice has not been supported strongly. Informal institution is emphasized in past studies as more difficult to understand than the formal ones (Zaheer, 1995). Challenges posed by the cognitive and normative institution of host countries are greater and more implicit (Ionascu, Meyer & Erstin, 2004). Probably, the joint venture linkage with foreign partners in home country could transfer “hard” knowledge about the formalized rules. But the “soft” knowledge about cultural difference could not be attained just through homeland network ties due to its tacitness. Costly direct experiences are more valuable for firms to get through this tough cultural barrier according to our results.

## Theoretical Contribution

Our study has several contributions and could provide implications for literature on FDI location choice of EMNEs. First, to extend our understanding on the location behavior of EMNEs, underlying firm heterogeneity is explored in the present study. Conventional studies based on economic theory, which presumes the managers are rational, emphasize the profits and cost calculation in determining the location strategy (Buckley, Devinney & Louviere, 2007). Our research interests focus on the learning process of firms following the organizational learning theory (Levitt and March, 1988). Since country level attributes has been investigated in tremendous studies (McCann & Mudambi, 2004), firm level traits except for experience and network should be explored more in the future, such as ownership (Duanmu, 2012), home origin (Holburn & Zelner, 2010), strategic intention (Lu, Liu & Wang, 2010) and other variables might take effect on location behavior of MNCs. Especially, most of existing empirical studies on EMNEs use macro data and lack firm level observations to provide a thorough explanation of their internationalization process (Lu, Liu & Wang, 2010; Yuan & Pangarkar, 2010).

Second, we provide the empirical evidence that experience matters for emerging economies MNCs, at least for their perceived risk posed by formal and informal institution of host countries. A large body of research examined the role experiential learning played in of developed economies MNCs’ entry mode strategy (Gaur & Lu, 2007; Schwens, Eiche & Kabst, 2011), location choice strategy (Delios & Henisz, 2003; Erramilli, 1991) and subsidiary performance (Gaur & Lu, 2007; Luo & Peng, 1999). Seldom empirical research addresses the counterpart effect of experience on EMNEs to our knowledge, despite that the aggressiveness and radicalness of the internationalization of EMNEs are highlighted (Gammeltoft, Barnard & Madhok, 2010). A natural extension of our study could thus further explore how other internationalization strategy, behavior and performance, such as the mode strategy and performance of foreign subsidiaries vary with experiential learning of EMNEs.

Third, our study argue that the network linkage to foreign firms built in home country facilitate Chinese firms in expanding to distant and risky markets. Researchers could further explore how firms learn to internationalize through network ties. For example, this argument could advance by examine the underlying learning mechanism, including information exchange, capability building and resource augmenting, which are all discussed in network approach based studies (Chen, 2003; Yiu, Lau & Bruton, 2007). The relational and structural attributes of network could also be stretched in future studies, such as business ties or institutional ties, formal or informal ties, strong or weak ties, centrality or structural hole.

This research agenda would enrich the network view on internationalization (Johanson & Vahlne, 2009).

Fourth, our empirical results based on Chinese manufacturing firms provided some similarity of EMNEs and their Western counterparts. For example, they both are averse to under developed institutional environment and the experiential learning is important for them to make FDI location choice. However, we do argue that the deep-seated strategic motivation of EMNEs should be scrutinized with caution. Scholars could examine the institutional escape intention of EMNEs compared with firms from well-established institutions. So, comparing studies on MNCs from emerging economies and developed economies could be conducted. Theoretical arguments about the distinctiveness of international strategy and behavior EMNEs are identified in many researches, but the empirical support is still needed (Child, & Rodrigues, 2005; Luo & Tung, 2007; Gammeltoft, Barnard & Madhok, 2010). Comparing research would inform us more about the behavior and strategy of the first movers and those late comers in global arena.

### Managerial implication

International market selection is major concern for managers of MNCs (Buckley, Devinney & Louviere, 2007). For firms in emerging economies like China, “going global” is both fascinating and poisonous. It is nothing new to see the unwise or even destructive decisions of Chinese firms in their way to the overseas market. Our study has some implications for those Chinese firms have or will have foreign direct investment.

First, potential risks of host countries derived from the cultural distance or institutional voids should be evaluated before making location choice. A due diligence is conducive for firms to cope the hurdles from the cognitive, normative and regular institution (Klossek, Linke & Nippa, 2012). As our empirical results and other research suggested, cultural barriers are more challengeable, thus need more attention of managers to understand the difference between home country and host countries, when making international strategic choice (Ionascu, Meyer & Erstin, 2004).

Second, managers could learn from past experiences to build institutional knowledge. Direct operation in foreign markets is the only way for firms to accumulate experiential knowledge (Eriksson *et al.*, 1997). This path dependent knowledge thus is valuable and useful for firms to address problems more legitimately caused by cultural distance. As our study suggested, experience has stronger effect in moderating the relation between cultural distance and location choice than joint venture network tie.

Third, for emerging EMNEs born in a highly internationalized setting, international network ties could be leveraged to facilitate their foreign market entry and operation. In our study, those firms have alliance linkage with foreign MNCs are more likely to exploit the market potential or other assets in institutional risky countries. This indicated that managers could also obtain knowledge and information through interaction with their foreign partners except for through direct experience. And, other network ties also could be leveraged for EMNEs to learn about the global market, such as their interaction with customers and suppliers.

## Limitations

Our study has several limitations need to be refined theoretically and empirically. First, experiential learning is a major theoretical interest, but we have only operationalized the FDI experience using a dummy variable. Future studies could explore the longevity and scope proxy used in previous studies (Erramilli, 1991), in order to examine non-linear effect of experiential learning. Also other experience such as the export experience could be investigated as the way of international learning by non-equity investment

Second, we only choose the equity alliance tie as the means of network learning due to the limitation of information exposed by annual report. Other network relationship could be added for further discussion. Also, the learning mechanism could be detected and deepened in future study. Empirical studies could be designed to investigate the process of information exchange or knowledge sharing among network members.

Third, in order to generalize our finding to other EMNEs, more samples are needed in future studies. Our data is only collected from manufacturing listed firms in China. Research on diverse samples is called to extend the knowledge about the global learning in the process of internationalization of EMNEs, such as those non-public firms, firms from other industry and from other emerging economy.

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## APPENDIX I . MEASUREMENT AND DATA SOURCE OF VARIABLES

|                      | Variable                  | Measurement   | Data Source                            | Reference                              |                       |
|----------------------|---------------------------|---|--|--|-----------------------|
| Dependent variable   | Entry <sub>ixt</sub>      | (0,1) if the firm x invest in the country I in year t   | Annual Reports of the public companies | Henisz&Delios(2001)                    |                       |
| Independent variable | Cultural distance         | 4 cultural dimension of Hofstede (1980)                 | geert-hofstede.com                     | Kogut and Singh(1988)                  |                       |
|                      | Formal institutional Risk | Index Economic Freedom; Worldwide Governance Indicators | Heritage Foundation; World Bank        | Bae& Salomon (2010)                    |                       |
| Moderators           | FDI experience            | Length  | Total years of FDI                     | Annual Reports of the public companies | Benito&Gripsrud(1992) |
|                      |                           | Frequency   | Total times of FDI                     |  |                       |
|                      | JV network tie            | Total number of joint venture                           | Annual Reports of the public companies | Chetty&Holm(2000)                      |                       |
| Control variables    | Resource                  | Energy production (kt of oil equivalent)                | World Bank WDI                         | Mina(2007)                             |                       |
|                      | GNI                       | GNI (current US\$)                                      | World Bank WDI                         | Davidson (1980)                        |                       |
|                      | GDP Growth                | Annual growth of GDP                                    |  |  |                       |
|                      | Technology                | Patent application by residents yearly                  | World Bank WDI                         | Yamawaki(2006)                         |                       |
|                      | Geographical Distance     | Physic distance between the capital cities              | www.geobyte.com                        | Flores & Aguilera (2007)               |                       |
|                      | FDI Inflow                | FDI inflow divided by GDP                               | World Bank WDI                         | Flores & Aguilera (2007)               |                       |

**APPENDIX II . RESULTS OF MULTINOMIAL LOGISTIC MODEL FOR LOCATION CHOICE**

| Variable                                   | Model 1    | Model 2   | Model 3    | Model 4    | Model 5    | Model 6    | Model 7    |
|--|------------|-----------|------------|------------|------------|------------|------------|
| Base Group: 0                              |            |           |            |            |            |            |            |
| Resource                                   | -0.247***  | 0.054     | 0.069      | 0.049      | 1.602      | 0.068      | 0.049      |
| GNI  | 1.953***   | 1.594***  | 1.601***   | 1.607***   | 0.035***   | 1.604***   | 1.611***   |
| GDP Growth                                 | 0.049**    | 0.031*    | 0.031†     | 0.033†     | -0.602*    | 0.033†     | 0.036*     |
| Technology                                 | -0.662***  | -0.599*** | -0.607***  | -0.593***  | -0.950***  | -0.608***  | -0.594***  |
| Geography Distance                         | -1.030***  | -0.942*** | -0.946***  | -0.942***  | 1.302***   | -0.948***  | -0.944***  |
| FDI Inflow                                 | 1.240*     | 1.255     | 1.360†     | 1.290†     | -0.545†    | 1.370†     | 1.298†     |
| Cultural Distance                          |            | -0.554*** | -0.533***  | -0.535***  | -0.959***  | -0.531***  | -0.530***  |
| Formal Institutional Risk                  |            | -0.962*** | -0.937***  | -0.908***  | 0.107***   | -0.938***  | -0.908***  |
| Cultural Distance × Frenquency             |            |           | 0.122***   |            |            | 0.113**    |            |
| Formal Institutional Risk × Frenquency     |            |           | 0.168***   |            |            | 0.151**    |            |
| Cultural Distance × Length                 |            |           |            | 0.113**    |            |            | 0.095**    |
| Formal Institutional Risk × Length         |            |           |            | 0.197***   |            |            | 0.175**    |
| Cultural Distance × JV network tie         |            |           |            |            | 0.188†     | 0.035      | 0.082      |
| Formal Institutional Risk × JV network tie |            |           |            |            | 1.602***   | 0.095      | 0.106      |
| Obs  | 14606      | 13057     | 12983      | 12687      | 13057      | 12983      | 12687      |
| Log likelihood                             | -1295.7297 | -1220.801 | -1200.5873 | -1173.6551 | -1216.3277 | -1199.8027 | -1172.1215 |
| LR chi <sup>2</sup> (5)                    | 524.74     | 549.35    | 571.36     | 551.58     | 558.29     | 572.93     | 554.65     |
| Prob > chi <sup>2</sup>                    | 0.0000     | 0.0000    | 0.0000     | 0.0000     | 0.0000     | 0.0000     | 0.0000     |
| Pseudo R <sup>2</sup>                      | 0.1684     | 0.1837    | 0.1922     | 0.1903     | 0.1867     | 0.1927     | 0.1913     |

†p<0.1; \*p<0.05; \*\*p<0.01; \*\*\* p<0.001