UNIVERSIDADE NOVE DE JULHO
PROGRAMA DE MESTRADO E DOUTORADO EM ADMINISTRAÇÃO

CHRISTIAN DANIEL FALASTER

FOREIGN FIRMS' STRATEGIC RESPONSES TO THE INSTITUTIONAL ENVIRONMENT IN LATIN AMERICAN COUNTRIES

São Paulo

2017

Christian Daniel Falaster

FOREIGN FIRMS' STRATEGIC RESPONSES TO THE INSTITUTIONAL ENVIRONMENT IN LATIN AMERICAN COUNTRIES

RESPOSTAS ESTRATÉGICAS DAS EMPRESAS ESTRANGEIRAS AO AMBIENTE INSTITUCIONAL NA AMÉRICA LATINA

Tese apresentada ao Programa de Pós-Graduação em Administração da Universidade Nove de Julho – UNINOVE, como requisito parcial para obtenção do grau de **Doutor em Administração**.

Orientador: Prof. Doutor Manuel Aníbal Silva Portugal Vasconcelos Ferreira
Co-Orientador: Prof. Doutor Fernando Antônio Ribeiro Serra

São Paulo

2017

FICHA CATALOGRÁFICA

Falaster, Christian Daniel.
Foreign firms' strategic responses to the institutional environment in Latin American countries. / Christian Daniel Falaster. 2017.

120 f.
Tese (doutorado) – Universidade Nove de Julho - UNINOVE, São Paulo, 2017.
Orientador (a): Prof. Dr. Manuel Aníbal Silva Portugal Vasconcelos Ferreira.

Strategy. 2. International Business. 3. Institutional theory. 4. Institutional environment. 5. Adaptation.
Ferreira, Manuel Aníbal Silva Portugal Vasconcelos. II. Titulo.

CDU 658

FOREIGN FIRMS' STRATEGIC RESPONSES TO THE INSTITUTIONAL ENVIRONMENT IN LATIN AMERICAN COUNTRIES

POR

CHRISTIAN DANIEL FALASTER

Tese apresentada ao Programa de Pós-Graduação em Administração - PPGA da Universidade Nove de Julho – UNINOVE, como requisito parcial para obtenção do título de Doutor em Administração, sendo a banca examinadora formada por:

_____

Prof. Dr. Manuel Aníbal Silva Portugal Vasconcelos Ferreira – Universidade Nove de Julho – UNINOVE

_____

Prof. Dr. Fernando Antonio Ribeiro Serra – Universidade Nove de Julho – UNINOVE

_____

Prof. Dr. Júlio Araújo Carneiro da Cunha – Universidade Nove de Julho – UNINOVE

_____

Profa. Dra. Priscila Rezende da Costa – Universidade Nove de Julho – UNINOVE

_____

Profa. Dra. Maria Tereza Leme Fleury – Fundação Getúlio Vargas – EAESP

_____

Prof. Dr. Felipe Mendes Borini – Escola Superior de Propaganda e Marketing - ESPM

São Paulo, 20 de Fevereiro de 2017.

DEDICATÓRIA

Dedico este trabalho à minha mãe, Gianna e aos meus avós,
Arlindo e Marly; Darcisius e Elvira

AGRADECIMENTO

Agradeço primeiramente aos meus pais e à toda a minha família por me fazerem a pessoa que sou hoje, especialmente à minha mãe, Gianna, por ter me ensinado a me empenhar para chegar aonde quero.

Agradeço ao meu orientador, Professor Doutor Manuel Portugal Ferreira e ao meu co-orientador Professor Doutor Fernando Ribeiro Serra por acreditarem em mim e dedicarem seu tempo e esforço à minha formação.

Agradeço ao Professor Doutor Emerson Maccari por fazer do PPGA da Uninove o sucesso que ele é hoje. Agradeço também ao nosso Reitor, Eduardo Storópoli e nossa pró-reitora acadêmica, Maria Cristina Storópoli por acreditarem na importância do *stricto sensu*.

Agradeço aos demais professores do PPGA Uninove por tudo o que aprendi e por todas as vezes que me ajudaram quando precisei. Em especial aos professores Dirceu da Silva, Evandro Lopes, Júlio Cunha, Leonel Rodrigues e Reed Nelson pela ajuda teórica e empírica para este estudo. Agradeço também à equipe do PPGA da Uninove, em especial ao Altieres, à Marcela, à Madu e à Andressa por sempre resolverem os problemas rápida e assertivamente.

Agradeço aos professores Maria Tereza Fleury, Affonso Fleury e Moacir Oliveira Jr. por me aceitarem para as aulas no programa de matrícula cruzada.

Agradeço aos meus colegas por passarem por essa etapa junto comigo, sempre lá quando eu precisei, em especial agradeço a Zanin, Guerrazzi, Fellipe, Biagi, Mangini, Dantas, Léo, Fernando, Gustavo, e, é claro, ao Mazzieri. Agradeço também ao amigo Leandro (in memoriam) que pelo destino não pôde concluir o doutorado conosco. Em especial agradeço à Claudia pela parceria nos artigos.

Agradeço aos meus amigos, Alan, Fili, Gilby, Iran, Juarez, Levi, Lucas, Pedro, Xiristen, Braun, Rony, Rizzo, Julio, Fernando, Cadu, Gustavo, André, Lucas, Thiago, Mew, Edu, João, Alvaro, Tiago, Thiago, André, Diego, Paulo e Arthur.

Agradeço em especial à minha tia, Fabricia, por ter me incentivado e me ajudado no meu ingresso na academia e ao Clóvis por ter me ajudado nestes primeiros passos.

ABSTRACT

In this thesis, I propose an analysis of how the inefficient institutional environments found in Latin America influence the strategic responses of foreign firms. Specifically, I develop three distinct and interconnected studies, each with its own conceptual development and methods. The first study investigates the existence of two dimensions in institutional inefficiencies, one pervasive and the other arbitrary, and how these dimensions impact on the decisions of entry mode. The second study investigates how the institutional differences between regions influence the strategies of entry mode. The third compares the performance of local and foreign firms in institutionally inefficient environments and indicates under what circumstances foreign firms can perform better than domestic ones. Finally, this thesis contributes to institutional theory in international business by explaining part of the complexity of institutionally inefficient environments and how firms strategically react to adapt to these environments.

Keywords: Strategy, International Business, Institutional Theory, Institutional Environment, Adaptation.

RESUMO

Nesta tese, eu proponho uma análise de como os ambientes institucionais ineficientes encontrados na América Latina influenciam as respostas estratégicas das empresas estrangeiras. Em específico, são realizados três estudos distintos e interconectados, cada um com um desenvolvimento conceitual e métodos próprios. O primeiro estudo investiga a existência de duas dimensões nas ineficiências institucionais, uma generalizada e a outra arbitrária, e como estas dimensões impactam nas decisões de modo de entrada das empresas. O segundo investiga como as diferenças institucionais entre regiões influenciam as estratégias de modo de entrada. O terceiro compara o desempenho de empresas locais e estrangeiras em ambientes institucionalmente ineficientes e indica em que circunstâncias as estrangeiras podem desempenhar melhor do que as domésticas. Por fim, este estudo contribui para a teoria institucional em negócios internacionais por explicar parte da complexidade dos ambientes institucionalmente ineficientes e como as empresas reagem para se adaptarem a estes ambientes.

Palavras-chave: Estratégia, Negócios Internacionais, Teoria Institucional, Ambiente institucional, Adaptação.

INDEX

TABLES INDEX

Chapter 2

Chapter 3

Chapter 4

FIGURES INDEX

Chapter 2

1 CHAPTER 1 - INTRODUCTION

Institutional theory has the capacity to explain components of business outside, or beyond, the more traditional pure market and economic rationale. The institutional environments where societies are immersed shape interactions between individuals and firms (North, 1990). Institutions determine how firms operate and how industries behave and even evolve as they follow and shape the prevailing norms, rules and pressures (Meyer & Rowan, 1977).

In international business and strategy studies we are often concerned with firms' strategies, structures and performance, in a traditional that dates back to Chandler (1962). Expanding internationally, firms face the pressures to adapt their strategies but also structures to the foreign institutional environment (Kostova & Roth, 2002; Ferreira & Serra, 2015). In some instances, the foreign environments differ so markedly from the home country that the risks and costs increase pronouncedly. Under these conditions, firms, and multinational corporations, select the entry strategy that better enables dealing with the hazardous conditions. To a large extent, in strategic management and international business studies scholars have been dealing with these issues using an institution-based view (Peng et al., 2008). An institutional perspective has been, for instance, used to examine such issues as firms' strategies (Peng et al., 2008), location choices (Lu et al., 2014), entry modes selected (Meyer et al., 2008), and the ownership structure preferred under uncertainty (Brouthers & Brouthers, 2003), among other strategic responses to institutional upheavals (Ismail et al., 2008).

In expanding internationally it is recognized, and to some extent well studied, that firms need to conform and adapt to the host institutional arrangements (Guissinger, 2001; Kostova & Roth, 2002) as a manner to attain legitimacy (Suchman, 1995, Meyer et al., 2014) that is crucial for both survival and future prosperity. That is, firms suffer pressures to adapt to regulations (DiMagio & Powell, 1983), norms (Lu, 2002), culture (Peng et al., 2008) and the general rules of the game in the country (North, 1990), or the formal and perhaps even more important the informal ways of conducting business. However, the host institutional environment entails risks and costs associated with the investment (Henisz, 2000). Hence, adaptation costs, risks, institutional pressures and the search for legitimacy will all shape firms' strategic responses to the institutional environment.

In the past decades, there has been a significant progress in the literature on the effects of the institutional environment on firms' international strategies. Despite these notable

progresses, many issues have remained either little explored or even largely unknown, thus rendering that a better and more profound grasp of the international business environment is still warranted (Ferreira et al., 2009). Moreover, while the institutional environment has been acclaimed as one of the key dimensions for the understanding of international business strategies – that led Peng et al. (2008) to propose it as a third leg in a strategy tripod – the differences across firms, countries and regions are prone to raise the level of complexity in researching the effects of the institutions on firms' actions. For instance, the institutional environment in Latin America is in flux as several Latin American countries are implementing more advanced pro-market reforms to build a more efficient and effective market-based economic structure. In an environment in flux the institutional changes are actual open spaces where different types of inefficiencies may arise (Khanna & Palepu, 2000a) making more difficult efficient market interactions (Meyer, 2001). In fact, under different institutional inefficiencies firms will also strategize differently, as research on the strategic responses to institutional environments has been showing (see, for instance, North, 1990; Oliver, 1991, Meyer et al., 2009; Rodriguez et al., 2005; Meyer et al., 2014). Hence, the overarching research theme that is foundational to this thesis is understanding how inefficient institutional environments influence international strategic responses of firms.

For this thesis, I use Latin America as the background, or empirical context, of institutionally inefficient environments and firms' responses (be these responses the ownership in foreign deals or the actions to improve performance in the local market). The context of Latin America is relevant for a number of reasons. First, since this is the context and by studying Latin America and Brazil specifically I increase the stock of knowledge that may be used by other scholars, managers and policy makers. Studies on Latin America have become increasingly important due to the emerging status of many Latin American countries (Cuervo-Cazurra, 2008; Cuervo-Cazurra & Dau, 2009), as Mexico and Brazil. Second, despite having inefficiencies in its institutional environment, some Latin American countries have sprawled a number of emerging multinational companies – also called multilatinas - that have successfully gained international prominence (Fleury et al., 2015). In this regards, understanding the local home country institutional environment is relevant as a contribution to figuring out how can these multilatinas have managed to compete with foreign firms in their domestic market. Third, Latin America poses an interesting research agenda because of its idiosyncratic institutional framework, which represents considerable differences in levels of development that must be taken on account in international business. It is especially relevant

that studying Latin America I may deep the understanding of the functioning of institutions. This is, at least in part, because of the institutional transformations that take place as the Latin American governments implement pro-market reforms.

I contribute to institutional theory and international business by providing a more detailed view of how inefficient institutional environments shape international business. I delve into detail in institutional inefficiencies by proposing the effects of different facets (pervasive and arbitrary). Specifically, I contribute to institutional theory by providing two new dimensions for institutional inefficiencies, pervasive and arbitrary institutional inefficiencies. These dimensions can help to explain why firms may use different strategies to enter countries that seem to have the same level of institutional development, providing a more detailed view of institutional inefficiencies. These dimensions can also be used in public policy as targets for institutional reforms from governments in order to develop the institutional environment of countries. For executives, pervasive and arbitrary institutional inefficiencies may assist in decisions of entry mode and in the overall analysis of the institutional environment in international business.

I contribute to international business by providing a new level of analysis of the institutional environment by proposing that regional institutional characteristics also matter in strategic responses. The analysis of the region may assist scholars in analyzing the complexity of the institutional environments and provide a new set of explanations for strategic decisions that would not be completely satisfied by national characteristics. I also contribute by providing empirical evidence that these regional institutional characteristics have impact in entry mode. These analyses can be used by executives to develop strategic plans with more accuracy when engaging in cross-border acquisitions (CBAs) and by policy makers by providing directions that developing a region's institutional environment may help to make it more adequate for firms.

Finally, I also contribute to theory by providing an explanation of how specific characteristics of firms (business group affiliation and foreignness) can become an asset when dealing with institutional inefficient environments. The analysis drawn in this thesis can assist in future studies by providing evidence that, in institutionally inefficient environments, foreignness may not always be a liability. These findings have implications to practice as present the importance of business groups as a way to respond against the advantages of foreign firms.

My findings contribute to future research by providing a way to look at countries' institutional frameworks surpassing general country indicators and observing more in-depth effects. My contribution is extended to Latin America, my object of analyses. I bring light to issues of how the Latin American institutional frameworks shape two main facets of International Business, equity decisions of entry mode and firms' performance.

1.1 RESEARCH PROBLEM

The institutional environment influences firms' strategic decisions (Kostova & Roth, 2002; Meyer et al., 2009; Meyer et al., 2014; Pinto et al. in press). Firms will respond differently to a different set of local conditions. One of the core strategic decisions in international expansions pertains to the choice of equity ownership (Chen, 2008; Ferreira et al., 2017). I particularly analyze how firms respond strategically to the inefficient institutional environments, as these environments may have pervasive inefficiencies and arbitrary inefficiencies, by deploying different ownership choices. Ownership is, at least to some extent, a structural response that firms make to the foreign institutional conditions (Ferreira, 2008; Pinto et al., in press). Another strategic response entails governance issues, such as affiliating to a business group for instance. This may be especially relevant under specific institutional conditions such as those inefficiencies found in less institutionally developed countries. I therefore also investigate the performance of domestic and foreign firms in inefficient institutional environments, by analyzing the strategic responses of domestic firms to compete against their foreign peers in the home country.

As noted previously, research has been munificent in exploring how the country differences in institutional development have an influence in firms' decisions. However, it has been scant in taking a more in-depth perspective on what do the institutional inefficiencies consist of and how the institutional development may vary within a country. Hence, in this thesis I tackle these issues by providing a two dimensions and a new level of analysis of the institutional inefficiencies in one hand, and on the other hand, I show how firms that are already operating in institutionally inefficient countries perform against domestic competitors.

Studies of Latin America are important to the discussion in International Business because most research in this area is devoted to explaining phenomena in countries with developed institutional environments (Oetzel & Doh, 2009). Research has been conducted to investigate aspects specific to Latin America (Cuervo-Cazurra, 2008) but it is still not clear how the Latin America's institutional inefficiencies influence firms, both domestic and foreign investors. In this thesis I address the effects of Latin America's environment on

acquisitions and operations of firms that have Latin America as their host. This is best achieved by examining how domestic, foreign owned and partnerships between domestic and foreign firms perform under conditions of institutional inefficiencies.

This research problem identified is in line with current research proposed by Cuervo-Cazurra (2008) and his call for additional studies about the Latin America or using Latin American countries as the context. The studies presented are also aligned with Peng et al.'s (2008) encouragement for researchers to take the institutional context as a third leg of the strategy tripod in international business.

1.1.1 Research question

The inefficiency of institutional environments is one of the main reasons for differences in development between countries (North, 1990). Foreign firms need to adapt to these institutional inefficiencies in order to obtain legitimacy and adapt to new countries (Meyer et al., 2014). Firms have to deploy strategic responses against the local institutional environments they enter (Peng et al., 2008). These strategic responses depend on a milieu of characteristics from the institutional environment, as the development, the risk and the uncertainty. Hence, with the objective of diving deeper in the characteristics of the institutional environment and how these characteristics influence strategic responses, the research question that propels this study is "How inefficient institutional environments influence international strategic responses of foreign firms".

1.2 OBJECTIVES

I may thus formulate a number of objectives entailed in this thesis. The more general objective is **to analyze how firms respond strategically to inefficient institutional contexts**. This objective is developed against firms' international operations and acquisitions of firms, in a Latin American setting. Certainly, given the local institutional inefficiencies and the flows of foreign direct investment into the Latin American countries an important issue to understand is how can local firms compete or outcompete with the large foreign multinationals. With this objective, it is possible to achieve a greater understanding of the institutional inefficiencies that permeate the settings of Latin America, as well as to understand how these inefficiencies affect firms' strategic responses.

1.2.1 Specific objectives

There are also a number of more specific objectives. To a large extent the three core objectives gave rise to the three studies comprising this thesis.

- Distinguish and operationalize two facets of institutional inefficiencies and analyze the effects of pervasive and arbitrary institutional inefficiencies on the ownership acquired by firms in CBAs;
- Distinguish within country variations across regions on the level and type of institutional inefficiencies, and analyze the effects of institutional asymmetries between regions on the ownership acquired by firms in CBAs targeting firms in institutionally inefficient countries;
- To analyze the performance differences between domestic and foreign companies in institutionally inefficient countries, seeking to further the understanding of strategic responses deployed by domestic firms to compete with their foreign counterparts given the institutional inefficiencies of the domestic market.

1.3 JUSTIFICATION FOR THE THEME

The institutional aspects of countries greatly shape strategies in international business (Peng et al., 2008). Meanwhile, it is important to understand that these institutional characteristics are not only determined by how developed institutions are, but also that there are different kinds of institutional development, regional differences and different strategic responses to inefficient institutions. Although many studies have explained different aspects of institutions influencing international business (see Kostova & Roth, 2002; Roth & Kostova, 2003; Cuervo-Cazurra, 2008; Peng et al., 2008; Meyer et al., 2009; Meyer et al., 2011; Meyer et al., 2014; Pinto et al., in press), there is still much to be discovered. Institutions shape human interaction and explain a great part of the disparities in development between countries (North, 1990), especially in international business, institutional theory is a fertile ground for researchers since countries have different institutional contexts, which can be extremely complex.

Due to this complexity, there is a need of expanding the knowledge about the institutional environment, its inefficiencies and the strategies that firms implement in order to adapt to these environments. In studies about corruption, there are indications that inefficiencies may have a pervasive dimension, which is predictable and generalized while there is a second dimension which is arbitrary, uncertain and unpredictable (Rodriguez et al., 2005; Uhlenbruck et al., 2006; Cuervo-Cazurra, 2008). If corruption is a bi-dimensional institutional inefficiency, other institutional inefficiencies might have a bi-dimensional nature as well.

Regional variations within a country are also sources of the complexity of the institutional environment. There are indications in literature that the regional characteristics are important for firm strategy (Beugelsdijk & Mudambi, 2013; Piscitello, 2011; Goerzen et al., 2013). Moreover, Beugelsdijk and Mudambi (2013) called for more attention to the fact that the countries are not completely homogeneous having slight (or even large) variations from one region to another. If there are important variations within a country, it is logical to question if there are institutional variations within a country and how these variations will affect firms' strategic responses.

Additionally, when dealing with institutionally inefficient countries, we are bound to find out that some previously established theories and predictions do not work the same way in developed and inefficient environments. In literature there are indications that in some cases, foreignness could be an asset rather then a problem for firms in countries that are emerging (Oetzel & Doh, 2009). Hence, it is important to question that if in institutionally inefficient countries foreign firms would have advantages rather than liabilities, would they perform better than domestic firms? And in what cases would the predictions of liabilities of foreignness be correct in these environments? Hence it is important to establish research to understand how foreign firms perform in institutionally inefficient environments and the strategic responses put forward by domestic firms to compete against them.

1.4 STRUCTURE

This thesis is organized in five chapters. The first chapter entails a broad introduction to the studies included in the thesis, explaining the foundational literature and core arguments. Chapters 2, 3 and 4 consist of three different but interrelated studies, each building on a specific research objective, as described previously. The last chapter is a broad integrative discussion of the studies conducted, pointing contribution, limitations and future research avenues. Using separate chapters to identify each study, I intend to develop the investigation on institutional inefficiencies, the types of inefficiencies and their influence on firms' decisions – or strategic responses - in Latin America.

In chapter 2, I develop the measures for pervasive and arbitrary institutional inefficiencies. I use institutional theory to build and test the effects of these facets of institutional inefficiencies in the ownership acquired in cross-border acquisitions (CBAs) in Latin America. The first chapter builds over the conceptualization by Rodriguez et al. (2005), Uhlenbruck et al. (2006) and Cuervo-Cazurra (2008), among others that have distinguished two types of corruption they termed as pervasive and arbitrary corruption. I expand on this

idea and take the institutional inefficiency suggesting that it is possible to actually find similar distinctions across a much larger array of institutional dimensions. This study thus helps us better conceptualize the different effects of institutional inefficiencies by actually proposing and testing partially the effects of arbitrary and pervasive institutional inefficiencies.

In chapter 3, I investigate the variances of institutional framework between regions of the same country. I perform an empirical study to test the effects of these variances on the ownership acquired in CBAs targeting the country. I extend the more common approaches when dealing with the institutional differences across countries and I propose that we may gain a better understanding if we take the level of analysis one level down to the more specific locations in which firms operate. I examine the regional institutional differences within the same country. I used the empirical setting of Brazil and the Brazilian states. I propose conceptually how the institutions may vary across regions within the country and empirically test that the regional variations will have an influence on the ownership acquired in CBAs targeting Brazilian firms. That is, foreign firms will act differently in response to the institutional differences across regions. This chapter draws on the propositions of Beugelsdijk & Mudambi (2013) that countries are not symmetrical and even in all their regions and cities, firms will choose one location against another within a country. This is interesting and the manner in which I extend the concept of pervasive and arbitrary regional institutional inefficiencies is likely to have a contribution to theory but also for managers and policy makers.

In chapter 4, I develop an argument of how foreign firms may perform better than domestic firms in institutionally inefficient countries in Latin America and what are the strategic response put forward by domestic firms to compete. I empirically test how business group affiliation and size may moderate domestic firms' performance. This study is relevant because, contrary to what Zaheer's (1995) liability of foreignness would predict, firms that are foreign will also enjoy some advantages of being foreign, which will likely make them more competitive than domestic firms. I compare the performance of these firms and propose the moderating role of firm size and business groups using an institutional argument.

The final chapter provides a discussion and conclusion, summarizing the findings of the thesis. I show my main contributions in this last chapter and point future research avenues.

2 CHAPTER 2: THE EFFECTS OF PERVASIVE AND ARBITRARY INSTITUTIONAL INEFFICIENCIES ON THE OWNERSHIP ACQUIRED IN CROSS-BORDER ACQUISITIONS

Institutions are the rules of the game in a society and shape human interaction (North, 1990). Institutional environments shape firms' operations (Hirsch, 1975; Rowan, 1982), strategic decisions (Oliver, 1991) and industry standards (Meyer & Rowan, 1977). Hence, firms entering foreign countries have to deal with costs to adapt to the new environment (Guisinger, 2001). Many scholars have delved into examining how the institutional environment and the institutional inefficiencies exercise influence on firms' foreign operations, acting as a determinant factor on international strategy (Peng et al., 2008). However, there is still a need for more detailed analyses of the institutional framework. In this chapter, I propose that there are two dimensions of institutional inefficiencies that affect firms' adaptation, the first, pervasive, the second, arbitrary.

Researchers have shown the dual nature of institutional inefficiencies before, specifically, analyzing corruption. Rodriguez et al. (2005) proposed that there are two natures of corruption, one pervasive, and thus predictable, that represents what firms expect from the environment and other arbitrary, thus uncertain of the incidence and outcomes of corruption. The mechanics of pervasive and arbitrary corruption have been showed to affect firms' strategy (Uhlenbruck et al., 2006), performance (Petrou, 2014), relationships with governments (Lee & Oh, 2007), as well as national FDI flows (Cuervo-Cazurra, 2008; Ferreira et al., 2016).

While most research on the dual nature of institutional inefficiencies has followed Rodriguez et al. (2005) and Uhlenbruck et al. (2006) by analyzing corruption, little has been studied on the possible duality of other institutional inefficiencies. Institutional factors as taxation, regulatory and economic policies are also susceptible to arbitrary changes that have direct impact on firms, influencing risk perception and adaptation (Henisz, 2000). These inefficiencies also have a pervasive and an arbitrary facet, each posing different adaptation costs that affect businesses in peculiar ways. Hence, it is possible to expand literature by proposing and analyzing the pervasive, or predictable and arbitrary, or uncertain aspects of institutions in a country.

In this chapter, I address how the pervasive and arbitrary faces of the institutional environment affect international business. Specifically, I analyze how the pervasive and arbitrary institutional inefficiencies will influence the ownership acquired by firms that perform CBAs in institutionally inefficient countries. I propose that the higher the pervasive institutional inefficiencies are, less will be the amount of ownership acquired, meanwhile, the higher the arbitrary facet of institutional inefficiencies, higher will be the amount of ownership acquired in order to guarantee control over the acquired firm's operations.

The empirical tests used a dataset of 1,140 CBAs performed by foreign firms acquiring firms in Latin America. This context is especially interesting given that Latin American countries are often regarded as having a relatively poor institutional setting but they have simultaneously been traversing a period of pro-market reforms (Cuervo-Cazurra & Dau, 2009) that heightens unpredictability and institutional variations, possibly rendering higher levels of arbitrariness.

The results indicate that the pervasive and arbitrary aspects of institutional inefficiencies have different outcomes on the ownership acquired. On the other hand, results are solid to indicate that the arbitrary aspect of institutional inefficiencies have a positive effect on ownership acquired, contributing to Cuervo-Cazurra's (2008) suggestion that firms would prefer the "devil they don't know". The results also show that the interaction between the pervasive aspect and the arbitrary aspect also has a positive effect on the ownership acquired.

I contribute to international business theory in three manners. First, I provide a new way of conception for institutional inefficiencies, going out of the ordinary efficient-inefficient continuum to a two-dimensional concept. Hence, I explore how specific institutional inefficiencies can have a pervasive and an arbitrary sides, and how these characteristics will impact strategic responses. Second, conceptually I expand on Uhlenbruck et al.'s (2006), Cuervo-Cazurra (2008) and Ferreira et al. (2016) perspective of a duality of nature in corruption to other institutional inefficiencies. In so doing I also set a new manner to observe how institutional inefficiencies matter and which types are more likely to drive firms' strategies, entry modes and location choices. A third contribution to research on CBAs, by delving deeper on the manners that institutional inefficiencies affect ownership acquired and providing results that corroborate that control may be more important when uncertainty is high then when the very problems are more prominent.

2.1 THEORY REVIEW

A series of decisions surround the international expansion of firms. Firms need to choose over exportations, licensing, greenfield investments, acquisitions, joint-ventures and other forms of internationalization (Agarwal & Ramaswami, 1992). These choices involve different degrees of resource commitment in relation with different risks and uncertainties.

Cross-border Acquisitions (or CBAs) are an entry mode that carries some advantages. Through performing acquisitions, firms will enter the new market while also acquiring knowledge and technology through the target firm (Barkema & Vermuelen, 1998). The acquisition of knowledge will influence acquisition strategies and determine equity decisions (Gaffney et al., 2016).

Firms that perform acquisitions in their international expansion will have two modes of acquisition full-equity ownership and joint-venture. Full-equity ownership is self-explanatory and implies that the firm has no participation of other capital in the acquired firm while joint-ventures are performed when the acquisition is partial, maintaining a partner (Chen, 2008). The key element of equity decision is control, more equity will grant the firm a continuum of control while lower equity modes will result in shared control over the firm (Ferreira, 2008).

2.1.1 Institutions and international business

The institutional structure rules interactions in ways that alter the results expected in the classical economic approaches (Peng et al., 2009). That is, the institutional structure embedded in a country can change results of strategies, making what would be a certain success in a country into a possible trouble in another country. The institutional environment has an important role in many aspects of economy due to the imperfections of systems (North, 1990). On an economic perspective, a “good” institutional environment establishes a structure of incentives to reduce uncertainty and guarantee the efficiency of transactions (Dunning, 2006).

Institutions influence how firms act. The very formal structures of firms are bound to the “myths” of their institutional environment (Meyer & Rowan, 1977). The institutional environment will influence the way firms operate and the strategies they develop (Hirsch, 1975). Most institutional pressures drive firms’ actions to achieve and maintain legitimacy

amongst social actors (Suchman, 1995). The expectations of these actors (and the firms' view of these expectations) give raise to the "myths" that will influence firms' behavior.

The institutional structure will exercise pressures for multinational enterprises (MNEs) to adapt to the host structure (Meyer et al., 2014). These pressures are different in every country, depending on local institutional structures (North, 1990). Firms will have to deal with different formal and informal institutions that will affect the functionality of organizational forms (Zenger et al., 2000) in that country. The differences among countries will also mean different adaptation costs for obtaining legitimacy, since the actors will be different in each country (Suchman, 1995).

An institution-based view has shown to be especially useful for understanding an array of entry mode and location choices, among other phenomena, in International Business studies. Institutions affect MNEs because they represent potential advantages and disadvantages related to the host country (Bevan et al., 2004). These advantages and disadvantages will also help to explain FDI flows (Cuervo-Cazurra, 2008; Ferreira et al., 2016). Countries where, for instance, the government has institutionalized policies to leverage FDI will receive more FDI, while protectionist policies will reduce FDI inflows (Brewer, 1993).

One of the key concepts regarding the effects of institutions in MNEs is the institutional differences from home to host country, since high institutional distances mean great differences in rules of the game and hence additional costs for firms to operate there (Berry et al., 2010). The differences on institutional structures have been shown to influence liabilities of foreignness (Eden & Miller, 2004), ownership acquired in CBAs and knowledge-seeking behavior (Pinto et al., in press).

The institutional environment of countries target of FDI have been a central object studied in international business (see Berry et al., 2010; Meyer et al., 2014; Pinto et al., in press). Most research considers the institutional development of a country as a continuum from advanced, strong and developed to weak and underdeveloped (Delios & Beamish, 1999; Meyer, 2001; Dikova & Witteloostuijn, 2007).

Environments that ensure the effectiveness of markets are usually referred as strong institutional structures (Meyer et al., 2009). These structures encourage firms to respect the rules and be effective in transactions (Dunning, 2006). Stronger institutional structures will also provide trust for firms in contracting, reducing perceived risks (Oxley & Yeung, 2001).

Additionally, stronger institutional structures will make the country more prone to greenfield and full ownership acquisitions since firms will perceive less risk and will not have to enter with a partner to mitigate risks and learn (Barkema & Vermuelen, 1998).

Weak institutional structures, on the other hand, are environments that do not ensure that transactions in a market will be effective (Meyer et al., 2009). In other words, some countries have institutional environments that are more difficult (Cuervo-Cazurra, 2008) and that lack efficient market mechanisms (Khanna & Palepu, 2000a). The efficiency of institutions is crucial for FDI location choices, since countries with weak institutional structures will receive less FDI (Bevan et al., 2004). Institutions will define the functionality of organizational forms, hence inefficient institutions will raise uncertainties regarding the organizational form (Zenger et al., 2000).

2.1.2 Pervasive and arbitrary institutional inefficiencies

The general view of institutional development and inefficiencies as a continuum has brought significant advancements to literature. However, researchers have also shown that institutional inefficiencies do not do not affect all firms the same way due to firm-specific characteristics as business group affiliation (Khanna & Palepu, 2000a), country of origin (Cuervo-Cazurra & Genc, 2008) and government ties (Pinto et al., in press).

If institutions do not affect firms homogeneously, it is reasonable to question if all differences are firms' specific. If that is true, every firm would deal equally well as their peers in regards to their institutional environment, *ceteris paribus*. An alternative explanation is that institutions do not affect every firm in the same way because there are differences in treatment depending on the arbitrary decisions of agents. That is to say that the underdeveloped-developed continuum can be dismantled into two dimensions, one of the general quality of institutions, and another that represents differences in how institutions work amongst firms.

There are some indications in literature that there is more than one dimension of institutional inefficiencies. These indications come from research regarding corruption. Rodriguez et al. (2005, p. 385) propose the pervasiveness of corruption as "the average firm's likelihood of encountering corruption in its normal interactions with state officials" and "an expectation of the proportion of interactions with the state that will entail corrupt transactions". The pervasive component of corruption influences firms towards choosing non-

equity modes of entry in internationalization (Uhlenbruck et al., 2006), reduces FDI inflows (Cuervo-Cazurra, 2008) and diminishes performance of MNEs operating in host countries (Petrou, 2014). The second type of corruption studied by Rodriguez et al. (2005), Uhlenbruck et al. (2006), Cuervo-Cazurra (2008) and other researchers is the arbitrariness. Contrary to pervasive corruption, arbitrary corruption is an uncertainty measure that will indicate the chances of encountering bribe demands and the uncertainty of obtaining the expected results after bribing officials (Uhlenbruck et al., 2006). As Rodriguez et al. (2005, p. 386) conceptualizes, high arbitrariness of corruption result in "an enduring uncertainty regarding the size, target, and number of corrupt payments necessary to obtain an approval".

Although the researchers in pervasive and arbitrary corruption have shown important contributions to theory, in this chapter I argue that other institutional inefficiencies also have a pervasive and an arbitrary facet. Numerous institutional components of the institutional structure influence firms (Bevan et al. 2004). These components are usually analyzed on their pervasive, widespread and predictable facet, but the uncertainty of the institutional structure also plays an important role for firms (Wong & Boon-it, 2008).

The pervasive dimension of institutional inefficiencies draws its name from the meaning of "pervasive", which means generalized or widespread. Pervasive institutional inefficiencies represent how much the inefficiencies are imbricated in the structure and how inefficient is the structure. The widespread and generalized inefficiencies will raise transaction costs (Meyer et al. 2014) and make more difficult the economic development of countries (North, 1990). Pervasive institutional inefficiencies are the usually analyzed data on studies about the institutional structures. The pervasive institutional inefficiencies dimension is the traditional measurement of institutional inefficiencies as most researchers (Cuervo-Cazurra & Genc, 2008; Meyer et al., 2014) have analyzed data using a national mean of development of institutional components.

I define pervasive institutional inefficiencies as the predictable and generalized nature of institutional inefficiencies as being are the known odds that a firm has to encounter problems within the institutional structure and the known depth of these inefficiencies. This line of thought follows Rodriguez et al. (2005), Uhlenbruck et al. (2006), Cuervo-Cazurra (2008) and other researches that pointed that corruption has a pervasive nature. In this chapter, I extend this theory by proposing that other institutional inefficiencies also have a pervasive and thus predictable component.

Pervasive institutional inefficiencies are generally harmful for the operations of firms, but are also predictable therefore firms can know how to adapt to them and have strategic responses planned. However, the environment where firms are embedded will also pose uncertainties for firms' operations. Uncertainty is the unpredictability of variables in the environment that will impact firms' performance (Miles & Snow, 1978; Pfeffer & Salancik 1978). Firms cannot predict all elements of the institutional environment where they operate, hence, some environments will have a component of uncertainty. Uncertainty will raise risks (Miller, 1992) associated with the institutional environment. I propose that these uncertainties, in the institutional environment, are the arbitrary dimension of institutional inefficiencies.

Arbitrary institutional inefficiencies are the outcome of the arbitrary actions of agents that can influence institutions and how institutions will affect firms. Hence, environments that have institutional inefficiencies more arbitrary will have more uncertainty and therefore risks associated with them. Agents, especially political agents, can operate to change institutions and use their influence over institutions in order to serve self-interest (Miller, 1999) and give privileges to a firm or sector to the detriment of another. These influences over institutions will result in uncertainty, unpredictability and risk associated with the institutional environment.

I propose the concept of arbitrary institutional inefficiencies as the extent of uncertainty, unpredictability and risk associated with the institutional environment, fruit of arbitrary actions of agents. Arbitrary institutional inefficiencies will influence the uncertainty regarding the extent and target of the institutional inefficiencies, following the same principle of arbitrary corruption (Rodriguez et al., 2005). In other words, arbitrary institutional inefficiencies is reflected in the difference between firms from the same country regarding how much of an obstacle the institutional inefficiencies will be to them.

The basic institutional deficiency that already has been characterized with a pervasive and an arbitrary facet is corruption. As Rodriguez et al. (2005) first defined, the pervasive aspect means how much corruption is widespread, predictable and known in a country. Meanwhile, arbitrary corruption means the amount of bribes that will be necessary, the effectiveness of these bribes and, altogether, the actions that depend of arbitrary decisions made by political agents.

Following the same principles, political instability also has pervasive and arbitrary dimensions. Alesina et al. (1996, p. 191) have conceptualized political instability as "the propensity of a change in the executive power, either by constitutional or unconstitutional

means". The very concept that the authors defined as political instability brings the possibility of two different sources, possibility of changes in executive power by constitutional and unconstitutional means. The constitutional means represent the pervasive political instability, because the instability is embedded in the political system of the country. The lowest possible pervasive political instability is found in countries as China, where there are no constitutional means of changing the political party that seats at the executive. On the other hand, countries that have risks of the executive power changing hand by arbitrary decisions that ignore the constitutions as a *coup d'état* will have higher arbitrary political instability.

Tax rates can also have pervasive and arbitrary dimensions. Edmitson et al. (2003) show that there are two different dimensions in tax institutional inefficiencies, complexity and uncertainty. As Warskett et al. (1998, p. 123) conceptualize, complexity in taxes is related to the "numbers of tax rates, tax bases and special provisions it include". On the other hand, uncertainty in tax is characterized as the frequency of changes in tax laws (Hassett & Hubbard, 1997, Edmitson et al., 2003). In the two-dimensional institutional inefficiencies, complexity of tax rates is characterized as the pervasive tax rates inefficiencies because, although hard for firms, it is possible to predict and prepare against environments with high tax complexity. Meanwhile, the uncertainty is characterized as the arbitrary dimension, because it depends on changes proposed by political actors, being unpredictable. Brazil, for instance, is a good example of country that has high pervasive tax inefficiencies and arbitrary tax inefficiencies. The overall tax rates system in Brazil is very complex, additionally, states can pass laws to change and add taxes in their territories without greater refereeing from the union. Hence, firms have to prepare to pay taxes for every state they plan to sell to in Brazil, having a complex and uncertain, ever-changing tax system.

Another example is the institutional inefficiencies in workforce education. An inadequately educated workforce is fruit of institutions that do not foster and support education in a country (Early & Winston, 2001). Countries that have pervasive inadequate workforce education have a generalized system that does not foster workforce education. On the other hand, countries that have high arbitrary inefficiencies in workforce education have considerable differences between the education institutions. Where regions, income stratas and demographics have differences in workforce education due to privileges and prejudices in institutions, fruit of arbitrary interests of political agents.

Institutional inefficiencies also are present in infrastructure and have pervasive and arbitrary dimensions. Government policies and institutions are strongly tied to the

development of infrastructure (for instance, electricity and communications) (Henisz, 2002). When these institutional policies foster the development of quality infrastructure, firms will have the infrastructure that they need to properly operate. However, when public policies do not establish proper, reliable institutions for infrastructure, firms will face pervasive institutional problems with infrastructure. Firms will face arbitrary institutional deficiencies in infrastructure when operating in countries where agents can act in order to manipulate specific institutions that will foster a firm over the other, generating asymmetries between firms, sectors and regions depending on the arbitrary will of agents.

The two-dimensions of institutional inefficiencies can be generalized, classifying a country according to their average index of their institutional indicator in each dimension. Hence, it is possible to point out where a country stands in pervasive and arbitrary inefficiencies according to its general institutional environment. I show the general bi-dimensional matrix of institutional inefficiencies in Figure 2.1.

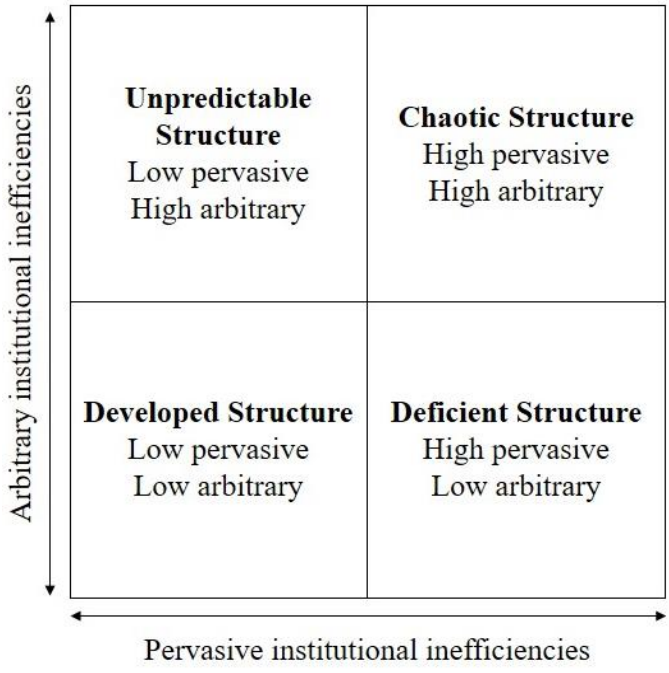

Figure 2. 1 Bi-dimensional matrix of institutional inefficiencies

Source: the author.

In the bi-dimensional matrix, it is possible to identify that there are four types of institutional structures according to pervasive and arbitrary institutional inefficiencies. A general perspective of the structure, contrary to a single indicator, forms these types of institutional structures. The structure types were named *Developed*, *Unpredictable*, *Deficient* and *Chaotic*.

Developed institutional structures are the ones usually found in developed countries. In these countries, there are low pervasive inefficiencies and low arbitrary inefficiencies. In other words, in developed institutional structures the problems in institutions are small and predictable, where agents cannot or will not abuse of their arbitrary powers to unbalance the structure. Doing business in developed institutional structures is easier because they are predictable and do not pose institutional threats to the firms' operations.

Deficient institutional structures are those where institutions are generally flawed but the outcomes are measurable and predictable. Hence, these countries will have high pervasive institutional deficiencies while having low arbitrary institutional inefficiencies. Countries that have extreme inefficiencies in their institutional environment are likely to have deficient institutional structures. When pervasive problems are too great, arbitrary problems will be low because agents will not be able to act arbitrarily to change legislation or to privilege selected firms. Having a deficient institutional structure is not necessarily better than a chaotic one. Deficiency happens in, for instance, poor African countries that are ruled by a dictatorship, where agents (other than the highest in power) have no power to take arbitrary decisions of changes in legal or political environments, hence the institutional structure is a great obstacle for every firm.

Unpredictable institutional structures are the ones in countries where the general quality of the institutional environment is good, but there is high arbitrary institutional inefficiencies. Arbitrary institutional inefficiencies happen by the acts of agents (mainly political agents) generating uncertainty and unpredictability in that environment. Countries that have an institutional structure that works well, but also have agents with enough power to arbitrarily change legislation or to use their power to benefit a firm over the other will have unpredictable institutional structure. This type of institutional structure is mainly transitory, happening when a country has a well-developed institutional structure on general, but some companies benefit while others may be hindered by the institutional inefficiencies.

Chaotic institutional structures have both high pervasive and arbitrary institutional inefficiencies. This type of institutional structure is largely characterized by known inefficiencies and generalized problems in institutions as well as constant changes, arbitrary actions by political agents and overall high uncertainty. It is very difficult for firms to adapt to this type of institutional structure because, contrary to deficient structures, firms cannot predict if their responses will be effective to adapt to the pervasive institutional inefficiencies.

2.2 HYPOTHESES

The institutional structure of the host market will influence ownership decisions (Contractor et al., 2014). Firms will choose to have higher degrees of equity in various occasions. When knowledge protection is low or economic distances are high (Gaffney et al., 2016). When institutional distances are high, their behavior is knowledge-seeking and when they have political support (Pinto et al., in press). When industry is related and when formal institutions are different (Contractor et al., 2014).

When institutional structure has high pervasive inefficiencies, thus a weaker institutional structure, firms will perceive higher risks (Henisz, 2000) and higher adaptation costs (Kostova & Roth, 2002). Higher risks related to institutional inefficiencies will have an impact on ownership decisions, because firms will choose lower equity CBAs to share risks (Chari and Chang, 2009). Lower equity modes can be used by firms to have a partner (Kostova & Zaheer, 1999), thus reduce hazards (Gatignon & Anderson, 1988; Lee et al., 2014) related to the new market, but also can be used for firms to learn to adapt and gain legitimacy (Meyer et al., 2014).

When firms can accurately observe and more easily predict the problems to be faced and the outcomes generated by predictable institutional inefficiencies, they can prepare and build strategies to mitigate risks associated with weak institutional structures. The choice for a partnership is a strategic response to high pervasive institutional inefficiencies because it helps firms with adaptation costs (Kostova & Roth, 2002) to obtain legitimacy (Kostova & Zaheer, 1999; Meyer et al., 2014). Hence, pervasive, and thus predictable, institutional inefficiencies will have a negative impact in the shares acquired in international acquisitions because firms can predict the need of strategic responses to the institutional inefficiencies that are pervasive. In the decision of ownership in CBAs, firms will perceive weak institutional structures, that have pervasive institutional inefficiencies, as more risky investments (Henisz, 2000) and thus will choose to acquire a lower ownership in order to have a partner from which firms can learn to operate in the weak institutional structure. Hence, I propose that:

> ***Hypothesis 1:*** *Pervasive institutional inefficiencies is negatively related to the ownership acquired in CBAs.*

On the other hand, the uncertainty regarding the institutional context also will raise risks associated with investment (Miller, 1992; Malhotra et al., 2016). Contrary to pervasive

institutional inefficiencies, arbitrary institutional inefficiencies are unpredictable. Unpredictable environments will raise uncertainties (Miller, 1992). Uncertainties will result in firms having difficulties to adapt and build legitimacy (Ferreira & Serra, 2015). Additionally, in environments with high uncertainty in institutional inefficiencies, managers are not always able to tell the extent that institutional inefficiencies will hinder them (Pinto et al. in press) and due to bounded rationality (Simon, 1955), they may not be able to accurately predict the effects of these environments.

Higher degrees of ownership can also be a protective behavior because they grant more control to the firm (Gaffney et al., 2016). Without control, it is difficult to coordinate actions, carry out and revise strategies (Anderson & Gatignon. 1986). With majority or ownership, firms can hire fresh labor forces, implement strategies and be free to change their strategies according to the necessity without having to obtain consent or negotiate with their partners (Chen, 2008). Firms entering in environments that have high arbitrary institutional inefficiencies will have to face an unpredictable environment of institutions that is in constant change. Firms will choose modes of higher ownership in environments of high arbitrary institutional inefficiencies because having more control over their operations will make it easier for firms to build rapid strategic responses and adapt to constant changes, rather than having to negotiate these responses with a local partner. Hence:

> ***Hypothesis 2:*** *Arbitrary institutional inefficiencies is positively related to the ownership acquired in CBAs.*

In a third perspective, it is possible to infer that there will be situations when both the pervasive institutional inefficiencies and the arbitrary institutional inefficiencies will be high, as in the *chaotic structure* type of environment. Particularly, in countries where the institutional system is weak and the structure is chaotic and unpredictable. In these cases, I will see both components of institutional inefficiencies working. Institutional inefficiencies will be pervasive and generalized, meaning that firms know they will face inefficiencies, but also do not know the extent of the problem they will face because of the arbitrary inefficiencies.

The extent of pervasive institutional inefficiencies will influence firms towards a lower degree of ownership, because of the difficulties in adapting and obtaining legitimacy (Kostova & Zaheer, 1999; Meyer et al., 2014). Meanwhile, the need of rapid strategic responses to an ever-changing environment will influence towards higher levels of ownership (Anderson & Gatignon, 1986; Chen, 2008). Firms are able to adapt to local institutions and achieve

legitimacy on their own, without having a partner, although it is more costly than learning from a local partner. However, it is not possible to perform immediate strategic responses to changing environments without having majority or full control over the firm. Any ownership structure that demands negotiation with a significant local partner will have to add the local partner's interests to the negotiation for strategic changes, making it almost impossible to perform immediate strategic responses to adapt to a changing environment. I predict that firms performing CBAs in *chaotic structures* will rather choose for higher ownerships in acquisitions to be able to have complete control over the firm and perform strategic responses than have a partner to help them adapt.

> ***Hypothesis 3:*** *The interaction between the pervasive institutional inefficiencies and the arbitrary institutional inefficiencies is positively related to the ownership acquired in CBAs.*

2.3 METHOD

To test the hypotheses, I have built a dataset of 1,140 cross-border acquisitions conducted by firms from continents others than Latin America investing in Latin America. Examining CBAs having Latin American countries as targets is adequate for the purposes for two main reasons. First, Latin America presents a milieu of institutional structures that are heterogeneously developed across countries and pose an array of inefficiencies and uncertainties that MNEs have to deal with (Pinto et al., in press; Cuervo-Cazurra & Dau, 2009). Moreover, these countries, albeit at disparate rates, and with varying levels of success, have endeavored in implementing pro-market reforms. The institutional environment is thus in flux and is prone to higher levels of unpredictability as the institutional settings transform. Thus, I may find a probably higher or more noticeable level of unpredictability, or arbitrariness, given the flux in the institutions.

Second, research on Latin America has been relatively scarce when compared to both developed countries and other emerging economies such as China and to a lesser extent India. The context of Latin America may help explaining phenomena related to institutional structures that are developing, still having several imperfections that are more difficult to identify in developed countries (Cuervo-Cazurra & Dau, 2009) and has thus a potential to contribute to theory development.

2.3.1 Sample

The sample for the statistical tests comprise 1,140 acquisitions performed by firms from other regions targeting Latin American firms. Data on the acquisitions was retrieved from Thomson-Reuters M&A database on EIKOS platform. In selecting the dataset for the sample I followed a number of procedures. First, I followed Pinto et al. (in press) excluded transactions involving countries of origin that are considered to be tax heavens - such as Bahamas, Cayman Islands and Barbados, - because these transactions could be episodes of round-tripping. Second, I also only considered CBA deals that were the first acquisition that the acquirer made in a given target firm. That is, I did not include subsequent partial acquisitions because these could be determined by the percentage acquired in the first acquisition (possibly raising endogeneity of the regression), and also influenced in a manner it is not possible to control for in the tests by the performance already achieved. Third, I only considered deals in which the equity stake acquired was greater that 5% of the equity since lower stakes could be speculative, short-term investments – often referred to as portfolio investments. Finally, I had to exclude observations for that had missing data in the variables of interest.

As could perhaps be expected, US firms conducted the larger number of CBAs in Latin America, totaling 358 CBAs. On the target side, Brazil was the country that received more CBAs, totalizing 381 acquisitions. Mexico followed with 218 CBAs. The number of acquisition per acquirer and per target country is depicted in table 2.1.

Table 2. 1 Sample

Acquirer country	n.	%	Target country	n.	%
United States	358	31.38	Brazil	381	33.39
Canada	239	20.95	Mexico	218	19.11
Spain	141	12.36	Argentina	142	12.45
United Kingdom	83	7.27	Chile	135	11.83
Australia	53	4.65	Colombia	78	6.84
France	48	4.21	Peru	75	6.57
Japan	32	2.8	Venezuela	28	2.45
Italy	27	2.37	Bolivia	13	1.14
Switzerland	20	1.75	Guatemala	12	1.05
Portugal	19	1.67	Ecuador	10	0.88
Sweden	16	1.4	Uruguay	10	0.88
Netherlands	15	1.31	Jamaica	7	0.61
China	12	1.05	Nicaragua	7	0.61
Germany	11	0.96	Dominican Republic	6	0.53
Belgium	8	0.7	Trinidad and Tobago	6	0.53
Ireland	8	0.7	El Salvador	5	0.44
Israel	8	0.7	Guyana	5	0.44
Norway	8	0.7	Honduras	3	0.26
India	7	0.61			
Luxembourg	6	0.53			
South Korea	5	0.44			
Denmark	4	0.35			
South Africa	4	0.35			
Malaysia	3	0.26			
Finland	2	0.18			
Philippines	2	0.18			
Greece	1	0.09			
Russian Federation	1	0.09			

Source: Author's calculations with data from Thomson Reuters M&A (2017).

2.3.2 Dependent variable

The dependent variable was the ownership acquired in each cross-border acquisition. I measured the ownership in a continuous variable as the percentage of equity acquired, following Chari and Chang (2009) and Chen and Hennart (2004). The use of a linear variable, ranging from 5% to 100% of shares acquired is adequate because it captures more nuances and when compared to dichotomous variables (Gaffney et al., 2016). It is worth noting that

the ownership stake acquired in a CBA reflects commitment of resources (Chen, 2008) and a preference for a given level of control over the target (Ferreira, 2008).

2.3.3 Independent variables

The independent variables reflect institutional inefficiencies. Following the hypotheses, I classified the institutional inefficiencies in two dimensions: pervasive and arbitrary. Both these dimensions were measured with data collected from the World Bank's Enterprise Surveys (data from 2006, 2009 and 2010 issues). This is a large-scale survey conducted by the World Bank in 114 countries mostly seeking to assess the local environment conditions for doing business. This data is made publicly available in the following website "http://www.enterprisesurveys.org/".

The survey includes a number of items labeled as "obstacles" to conducting business, from which I selected 16 items that are directly related to the external environment. The items pertain to questions such as "How much of an obstacle is corruption to this firm's operations?" and "How much of an obstacle is labor education to this firm's operations?". The responses to these items are given in a 5-point Likert type scale, anchored in 0 – no problem, to 4 – a very serious problem. The responses to these 16 items were then used to compute a measure of institutional arbitrariness and pervasiveness.

To compute the pervasive and arbitrary measurements of the institutional structure of a country, I followed Jong and Bogsman (2011) procedure of calculating pervasive and arbitrary levels of corruption and expanded that method to include the other 15 variables of WBES (World Bank's Enterprise Surveys). I first drew a single factor score to represent the general quality of the institutional structure perceived by the firm, using the 16 indicators. Uhlenbruck et al. (2006) and Cuervo-Cazurra (2008) also used factor analysis with WBES data in order to form measurements of institutional inefficiencies, but both were solely dedicated to corruption indexes. The charges resulting of this single factor score which is depicted in table 2.2. It is important to note that full data from WBES was used to construct this factor score, hence, I computed data from all countries present in the database, opening the possibility of using these measurements for countries from outside of than Latin America in future studies.

Table 2. 2 Single factor score

	Factor score
Tax administration	0.675
Corruption	0.652
Business licensing	0.643
Tax rates	0.614
Crime, theft and disorder	0.605
Labor regulations	0.597
Workforce education	0.586
Political instability	0.584
Transportation	0.583
Customs	0.571
Access to finance	0.533
Electricity	0.501
Access to land	0.500
Informal competition	0.481
Telecommunications	0.478
Unfair courts	0.215

Note: KMO = 0.899; Bartlet = p<0.000; Aprox. Chi-square 339331.90.
Source: Author's calculations with data from WBES (2009, 2010).

The factor score resulted in a generalized vision of the institutional inefficiencies that each of the firms experience. To calculate the national *pervasive institutional inefficiencies* I used the mean of the factor scores of every firm of that nation, following Jong and Bogsman's (2011) pervasive corruption measurement. The mean is a good indicator of pervasive institutional inefficiencies in a nation because it represents a generalized measurement of the institutional inefficiencies in that nation. A mean idealized the pervasive component because it ponders the inefficiencies throughout the number of firms, which represents the amount that the inefficiencies are widespread and deep, being therefore predictable and pervasive.

I also followed Jong and Bogsman (2011) by computing the national *arbitrary institutional inefficiencies* using the standard deviation between factor scores in the nation. The standard deviation captures the difference between firms' perception of the institutional environment in a country. Hence, the standard deviation is a suitable measurement for arbitrary institutional inefficiencies because of two main reasons. First, it exposes how institutional inefficiencies are different from firm to firm, providing a measurement of how firm-specific, location-specific and sector-specific characteristics will determine differences in the experience of institutional inefficiencies. These differences arise from the arbitrary

actions of agents that can bend, change and improve institutions. Second, it also portrays a measurement of uncertainty about the institutions in a country. When firms face an institutional environment where all firms experience the same amount of institutional inefficiencies, it is more predictable than an environment where firms have large differences in the way and extent they experience institutional inefficiencies amongst themselves.

2.3.4 Control variables

I used a number of control variables at the deal, firm and country level to rule out possible alternative effects and covariates that could influence the degree of ownership in CBAs. At the deal level, I controlled for the *transaction value* following Aybar and Ficici (2009), since larger transactions could have a negative effect on the ownership acquired due to the sheer financial cost associated with them resulting from the size of the target company. Data on transaction value was available in the Thomson-Reuters M&A database.

At the firm level, I controlled for the *acquirer firms size*, using the assets, because firms with larger pools of financial resources could have more resource slack that could make acquisitions less costly to them. Data on acquirer firm assets was collected from Thomson-Reuters M&A database. I also controlled for two types of firms' experience. First, *acquirer firms CBA experience in Latin America*, coded by counting the total number of CBAs a focal acquirer had conducted, and completed, in a Latin American country before the focal acquisition. Second, the *acquirer experience in country*, calculating the experience in the focal host Latin American country because firms with prior, and greater, experience in the country may perceive the acquisition as less risky than unexperienced firms. Experience in the country was coded by counting the total number of acquisitions undertook in the specific focal country before a focal deal, following Chari and Chang (2009). Data for these variables was collected from the Thomson-Reuters M&A database.

I further controlled for other acquirer and target firms' characteristics. First, I controlled if the acquirer and the target were technology-intensive, following Pinto et al. (in press), using the variables *target is hi-tech* and *acquirer is hi-tech*. High-tech firms may have different ownership decisions because they avoid having a partner to protect their knowledge and technology. The data is included in Thomson-Reuters M&A, and is coded as a dichotomous variable, with 0 – not high technology firm, and 1 – high technology firm. I also controlled if

acquirer or target firms were in manufacture industries using a dummy variable of 1 for manufacture and 0 for other, also following Pinto et al. (in press).

Finally, I included a number of country level controls. I controlled for the size of the home and host countries using the *total GDP*. Larger economies could mean market-seeking strategies that may have an impact on the equity ownership acquired. I also controlled for home and host country *GDP growth* to mitigate effects that could arise from years of economic prosperity or economic crisis following Lahiri et al. (2014). Country data indicators were retrieved from the World Bank (2016). I included a *U.S. firm* variable that is coded as 1 - for US acquirer firms and 0 - for non-US acquirer firms, following Uhlenbruck et al. (2006). US firms account for a large portion of the CBAs undertook in Latin America, and the US has a set of regulations that may influence CBAs due to rigid measures to avoid corruption and other specific transaction inefficiencies. I used a dummy variable coded as 1 for OECD member and 0 for non-OECD member to control if the *acquirer country is developed* or not.

2.4 RESULTS

Figure 2.2 depicts a comparative graph showing each dimension – pervasive and arbitrary – and how each of the Latin American countries is positioned according to their pervasive and arbitrary institutional environments. Brazil has the highest value for pervasive institutional inefficiencies amongst Latin American countries. Brazil, although being the largest economy in Latin America, has structural institutional problems related to the complexity of business regulations and taxes that firms face. For instance, from 1988 to 2013, Brazilian legislators passed 158,633 federal norms (altering and adding laws) and 29,694 tributary norms (Amaral et al., 2013). This complexity in Brazil raises pervasive institutional inefficiencies because it is hard for firms to adapt to the number of norms.

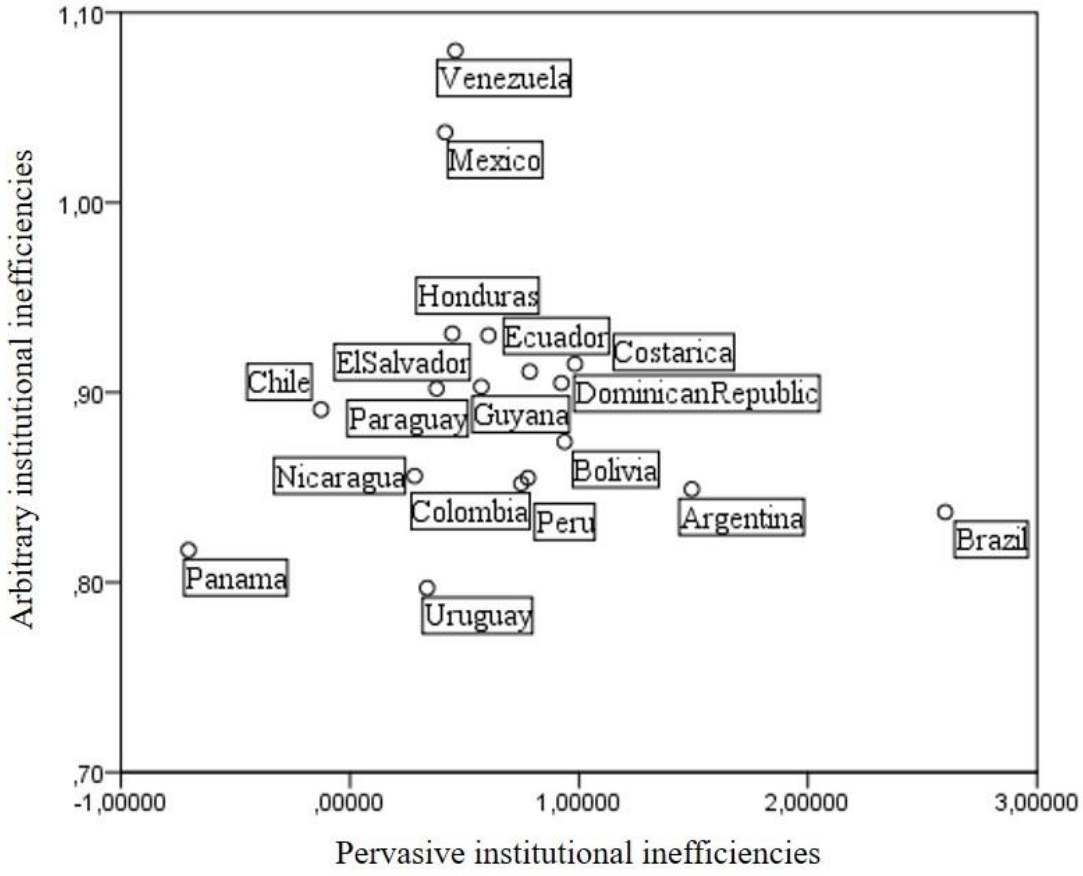

Figure 2. 2 Latin America according to Pervasive and Arbitrary institutional inefficiencies

Source: Computations by the author using data from WBES (2009, 2010). Drawn using SPSS.

Venezuela and Mexico have the highest value for arbitrary institutional inefficiencies. That is, these countries present foreign firms with greater arbitrariness and predictably more unforeseen risks and costs. The arbitrary institutional deficiencies in Venezuela are possibly explained by the political turmoil. Venezuela has been in an increasing conflict between entrepreneurs and the government since Hugo Chavez reached power in 1999. After Chavez's passing, in 2013, Nicolás Maduro assumed office and the governing party arbitrarily enacted several legal and regulatory changes that have led to the scarcity of basic food products, currency crisis, protests, arbitrary imprisonments and outright chaos in the country (Gomes et al., 2016).

In contrast, three Latin American countries have smaller institutional inefficiencies - Panamá, Chile and Uruguay. Panamá has undergone significant institutional changes in recent years. Government has implemented an array of institutional reforms towards a more

neoliberal agenda, enacting tax exemptions and fostering investments in infrastructure to become a commercial hub in the region (Sigler, 2014). The efforts to embed Panamá in the global value chains have led to an environment with lower pervasive and arbitrary institutional inefficiencies for firms.

In the Chilean case, it is possible to observe that the country has very low pervasive institutional inefficiencies and low arbitrary institutional inefficiencies. Chile went through the dictatorship of Augusto Pinochet during the 70-80's decades. Democracy was only reinstalled in the 90's, which called for profound constitutional, political and economic reforms to the country. These reforms greatly emphasized free trade, rule of law and balance between government powers (Fuentes, 2015). The reforms have been so successful in improving the institutional milieu that Chile has become a member of OECD in 2010.

Uruguay on the other hand is the country with less arbitrary institutional inefficiencies. This characteristic may be related to the social and labor reforms that have been taken place in Uruguay since 1940, which brought the country to a state of welfare that is more egalitarian having less social disparities of than in other Latin American countries (Finch, 2015). Countries that have higher social equality may have a population (and public agents) less prone to performing arbitrary acts in self-interest, hence lowering arbitrary institutional inefficiencies.

Table 2.3 summarizes the descriptive statistics – means and standard deviations - and correlations. Although some correlations are significant, there are no alarmingly high correlations to raise multicollinearity concerns. I also ran Variance Inflation Factor (VIF) tests and all values were below 5.

Table 2. 3 Descriptive statistics and correlations

		Mean	Std. Dev.	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16
1	Shares Acquired (%)	73.01	33.53	1															
2	Pervasive institutional inefficiencies	0.72	0.52	-0.054	1														
3	Arbitrary institutional inefficiencies	0.89	0.08	0.112**	-0.575**	1													
4	Transaction value	184.72	582.13	-0.048	0.048	0.000	1												
5	Acquirer firm size	45594.08	178604.74	-.0160**	0.010	-0.005	0.284**	1											
6	Acquirer CBA experience in Latin America	1.37	2.76	-0.118**	-0.043	-0.043	0.090**	0.147**	1										
7	Acquirer CBA experience in the country	0.45	1.09	-0.059*	0.100**	-0.045	0.047	0.046	0.623**	1									
8	Target High-Tech	0.27	0.45	0.052	0.126**	-0.154**	-0.077**	-0.109**	-0.115**	-0.078**	1								
9	Acquirer High-Tec.	0.27	0.44	0.088**	0.098**	-0.108**	-0.065*	-0.113**	-0.128**	-0.078**	0.671**	1							
10	Target industry	0.29	0.46	0.115**	0.146**	-0.073*	-0.016	-0.101**	-0.059*	-0.095**	0.341**	0.289**	1						
11	Acquirer industry	0.26	0.44	0.114**	0.165**	-0.067*	0.009	-0.126**	-0.049	-0.058	0.278**	0.376**	0.734**	1					
12	U.S. firm	0.31	0.46	-0.004	0.031	0.016	0.011	0.006	-0.034	-0.091**	0.092**	0.132**	0.161**	0.192**	1				
13	Target GDP growth	3.48	3.18	-0.005	-0.111**	-0.068*	-0.034	0.006	-0.014	-0.018	0.021	-0.003	-0.023	-0.018	-0.069*	1			
14	Acquirer GDP growth	2.64	2.12	-0.137**	0.018	0.015	0.021	-0.031	-0.049	-0.037	0.044	0.059*	0.018	0.056	0.045	0.168**	1		
15	Target country GDP	7.25E+11	7.17E+11	0.064*	0.616**	-0.094**	0.073*	0.006	-0.048	0.125**	0.071*	0.088**	0.061*	0.104**	-0.009	-0.077**	-0.168**	1	
16	Acquirer country GDP	4.75E+12	5.27E+12	0.011	0.048	-0.012	0.030	0.037	-0.015	-0.069*	0.089**	0.133**	0.151**	0.185**	0.926**	-0.038	-0.071*	0.124**	1
17	Acquirer country is developed	0.97	0.17	0.105**	-0.041	0.052	-0.007	-0.037	0.070*	0.054	-0.063*	-0.019	-0.032	-0.031	0.120**	-0.021	-0.320**	-0.060*	0.073*

Note: N = 1,141. * = p<0.05; ** = p<0.01; Source: authors' calculations using Thomson-Reuters M&A database.
Source: Author's calculations with research data.

Table 2.4 shows the statistical results of the tests of the hypotheses. Model 1 includes only the control variables. Model 2 tests the first hypothesis suggesting a direct negative effect of pervasive institutional inefficiencies on the ownership acquired in CBAs. The results confirm H1, showing a negative and significant effect (β=-0.153, $p<0.001$). This is consistent with interpretations that institutional inefficiencies will lead to a decrease in foreign investment, since firms will acquire less to avoid risks and have a partner to help them achieve legitimacy and adapt to the host environment.

In Model 3, I test H2 suggesting a positive effect of the arbitrary institutional inefficiencies on the ownership acquired. The results show a positive and significant effect of arbitrary of institutional inefficiencies on shares acquired, confirming hypothesis 2. Hence, in environments where there is high uncertainty due to arbitrary institutional inefficiencies, firms will prefer to have more control over their operations and be able to engage in strategic responses more freely.

Model 4 tests the third hypothesis proposing an interaction between the two independent variables. The result confirms hypothesis 3 by showing a positive and significant coefficient (β=5.708, $p<0.000$) for the interaction term. This result is revealing that firms entering countries that have inefficient institutional structures and the extent to which they matter varies, or that are uncertain, will tend to acquire a larger percentage of the target equity. Choosing higher control over the target is an alternative strategy to, for instance, having a partner to learn how to deal in this institutional structure.

Table 2. 4 Regression models for the ownership acquired

	Model 1	Model 2	Model 3	Model 4
Pervasive institutional inefficiencies		-0.153***		-6.003**
Arbitrary institutional inefficiencies			0.124***	-0.255*
Pervasive institutional inefficiencies * Arbitrary in institutional inefficiencies				5.708**
Transaction value	0.002	0.001	0.002	0.002
Acquirer firm size	-0.133***	-0.127***	-0.132***	-0.126***
Acquirer CBA experience in Latin America	-0.107**	-0.112**	-0.1**	-0.106**
Acquirer CBA experience in country	0.009	0.017	0.01	0.019
Target is High-Tec	-0.041	-0.028	-0.023	-0.031
Acquirer is High-Tec	0.062	0.054	0.063	0.057
Target industry	0.042	0.05	0.044	0.051
Acquirer industry	0.069	0.078†	0.072	0.08†
U.S. firm	-0.071	-0.015	-0.081	-0.031
Target country GDP growth	0.042	-0.018	0.049	-0.001
Acquirer country GDP growth	0.019	0.009	0.028	0.016
Target country GDP	-0.119***	-0.104**	-0.123***	-0.109**
Acquirer country GDP	0.028	0.129**	0.037	0.133
Acquirer developed	0.078*	0.081**	0.073*	0.076*
Adjusted r^2	.065	.077	.079	.085
Chi-square	98048.644	114869.131	116987.359	127014.513
F	6.662	7.384	7.533	7.267
Regression p-value	0.000	0.000	0.000	0.000
N	1.140	1.140	1.140	1.140

Note: The dependent variable is the percentage shares acquired in the target firm
† = p < 0.1; * = p < 0.05; ** = p < 0.01; *** = p < 0.001.
Source: Author's calculations with research data.

2.4.1 Post-hoc tests

For post-hoc tests, I expand the results by deconstructing the general measurements of pervasive and arbitrary institutional inefficiencies into more variables using a factor analysis comprehending the variables of WBES. I excluded variables that had communalities lower than 0.5 or single variable KMO lower than 0.6, following Hair et al. (2014). I used Direct Oblimin rotation method because it allows the factors to have some correlation. Correlation between the resulting factors is important in the case of institutional inefficiencies because it is expected. That is, I expect, for instance, that countries that have some more developed

institutional structures will generally have a more developed set of institutions, although some differences may arise. Thus, completely ruling out any correlation would be inadequate.

Table 2. 5 Post-hoc factor analyses

	Regulatory	**Infrastructure**	**Political**	Variable KMO	Communalities
Tax administration	**0.836**	0.293	0.127	0.768	0.702
Tax rates	**0.799**	0.248	0.067	0.773	0.651
Business licensing	**0.693**	0.359	0.156	0.885	0.493
Corruption	**0.660**	0.312	0.546	0.794	0.607
Telecommunications	0.213	**0.779**	0.114	0.795	0.613
Electricity	0.264	**0.772**	0.158	0.810	0.598
Transportation	0.365	**0.729**	0.060	0.840	0.548
Court system is unfair	0.053	0.081	**0.842**	0.878	0.727
Political instability	0.575	0.297	**0.580**	0.788	0.551
% of explained variance	36.116	13.672	11.212		
Cumulative explained variance	36.116	49.788	61.000		

Note: KMO = 0.803; Bartlet = p<0.000; Aprox. Chi-square 177877.82.
Source: Author's calculations with data from WBES (2009, 2010).

The results of the factor analysis are shown in Table 2.5. The factor analysis yielded a three factors solution that after careful examination of the items with highest loading I termed: regulatory, infrastructure and political inefficiencies. The total variance explained of the three factors was 61 percent, while the regulatory factor was responsible for the highest variance explained. The first factor comprises institutional inefficiencies related to taxes (tax administration and tax rates), business licensing and corruption. These are all dimensions that relate to the regulatory structure of the country, being formed by laws and regulations that affect directly and indirectly the operations of firms and how much these regulations are enforced. The second factor pertains to flaws in the institutional structure that comprises infrastructure problems, such as telecommunications, electricity and transportation. The third factor was formed by variables that are related to the actions of political and governmental agents, thus was labeled political institutional inefficiencies, comprising court system and political instability.

As an empirical extension I tested the direct effect of each factor of institutional inefficiency and their pervasive and arbitrary facets on the ownership acquired. Table 2.6 shows the results. I found that pervasive institutional inefficiencies in the regulatory (β= -0.134, p<0.001) and infrastructure (β= -0.52, p<0.05) are significantly and negatively related to ownership, in models 5 and 7 respectively. These results agree with the results from the

tests using the generalized *pervasive institutional inefficiencies* variable. This result shows that firms respond strategically to widespread problems in regulations and infrastructure by choosing lower equity modes that allow them to have a local partner in the country. Regulations and infrastructure are issues that, when predictable, can be learned from a partner. When the institutional structure has high pervasive problems in regulations and infrastructure, firms will know that the system is problematic and difficult to deal with, but will also know that the knowledge can be obtained through a partner.

Conversely, arbitrary institutional inefficiencies in the regulatory ($\beta=0.139$, $p<0.001$) and infrastructure ($\beta=0.102$, $p<0.01$) setting are significantly and positively related to ownership, in models 6 and 8 respectively. These results show another facet of regulations and infrastructure inefficiencies. When arbitrary inefficiencies are high in these variables, uncertainty is too high, so the knowledge of a partner is not as important for the firms' adaptation process, since it is impossible to predict the future problems based on the partner's knowledge. Firms will then deal with high arbitrary institutional inefficiencies in regulations and infrastructure by choosing to have more control and hence be able to respond more rapidly to changes.

The political dimension was not significant (Models 9 and 10). Possibly, this shows that the effects are different depending on the aspect of the institutional inefficiency that is being analyzed. Firms may not be able to strategically respond to political institutional inefficiencies, pervasive or arbitrary, since having a partner, or more control over their operations will not help them deal with these inefficiencies. The other explanation would be that the strategic response would be different against political institutional inefficiencies, as firms may prefer to use alternative (or even illegal, as offering bribes and gifts) means to deal with politicians and magistrates.

Table 2. 6 Post-hoc tests

	Model 5	Model 6	Model 7	Model 8	Model 9	Model 10
Pervasive inefficiencies in regulatory institutional structure	-0.134***					
Arbitrary inefficiencies in regulatory institutional structure		0.139***				
Pervasive inefficiencies in infrastructure institutional structure			-0.052*			
Arbitrary inefficiencies in infrastructure institutional structure				0.102**		
Pervasive inefficiencies in political institutional structure					0.03	
Arbitrary inefficiencies in political institutional structure						0.016
Transaction value	0.001	0.001	0.003	0.001	0.002	0.001
Acquirer firm size	-0.128***	-0.131***	-0.131***	-0.129***	-0.133***	-0.133***
Acquirer CBA experience in Latin America	-0.111**	-0.099**	-0.107**	-0.105**	-0.103**	-0.107**
Acquirer CBA experience in country	0.015	0.013	0.01	0.009	0.008	0.009
Target is High-Tech	-0.03	-0.024	-0.039	-0.032	-0.04	-0.039
Acquirer is High-Tech	0.053	0.066	0.06	0.057	0.062	0.061
Target industry	0.049	0.045	0.047	0.048	0.042	0.042
Acquirer industry	0.077†	0.073†	0.069	0.074†	0.068	0.07
U.S. firm	-0.015	-0.083	-0.071	-0.047	-0.079	-0.068
Target country GDP growth	-0.017	0.052	0.041	0.014	0.05	0.038
Acquirer country GDP growth	0.01	0.027	0.015	0.012	0.021	0.019
Target country GDP	-0.106**	-0.123***	-0.117***	-0.111***	-0.122***	-0.119***
Acquirer country GDP	0.122**	0.029	0.042	0.088*	0.022	0.03
Acquirer developed	0.083**	0.071*	0.078*	0.08*	0.077*	0.078*
Adjusted r^2	0.073556	0.083096	0.066612	0.070952	0.065049	0.076739
Chi-square	109899.5	121966.1	101116.2	106606.3	99139.69	98355.65
F	7.034111	7.887657	6.423786	6.804208	6.287696	6.233838
Regression p-value	0.000	0.000	0.000	0.000	0.000	0.000
N	1140	1140	1140	1140	1140	1140

Note: The dependent variable is the percentage shares acquired in the target firm;
† = p < 0.1; * = p < 0.05; ** = p < 0.01; *** = p < 0.001.
Source: Author's calculations with research data.

2.5 DISCUSSION

In this study, I analyzed how pervasive and arbitrary institutional inefficiencies influence the ownership acquired in cross-border acquisitions undertaken by foreign firms targeting Latin American firms. That is, I go beyond the arguments that institutional inefficiencies matter for foreign firms in selecting the entry mode or the ownership taken in the target firm and host country, to develop arguments that highlight a more fine grained

analysis of how institutional inefficiencies may be considered. In doing this, I extend on previous work that has distinguished two types of a specific form of institutional inefficiency – corruption – arbitrary and pervasive corruption (Cuervo-Cazurra, 2008). Hence, I proposed that, as corruption, other institutional inefficiencies have a pervasive and an arbitrary dimension and that these dimensions may actually have different influences for firms. I further provide partial tests distinguishing specifically an arbitrary and a pervasive dimension in regulatory, infrastructure and political institutional inefficiencies.

Pervasive and arbitrary institutional inefficiencies play different roles in the decision of ownership that firms make, as shown by the results. Pervasive institutional inefficiencies, that are generalized or widespread and "known" was shown to negatively influence the ownership acquired in CBAs. This is in agreement with both the literature on institutional inefficiencies influencing CBAs (Barkema & Vermuelen, 1998) and the pervasive nature of corruption (Uhlenbruck et al., 2006). Arbitrary institutional inefficiencies, on the other hand, seems to have a contrary effect. As the arbitrary institutional inefficiencies raise, the ownership acquired by firms also raises.

A number of explanations may be put forth to explain the positive effect of arbitrary institutional inefficiencies on ownership. It might be expected that firms would prefer forms of lower equity, such as joint ventures or partial acquisitions, for instance, when dealing with institutionally weak environments. A local partner could mitigate risks, promote learning, including of the host country's idiosyncrasies (Barkema & Vermuelen, 1998) and gain legitimacy in the host country (Meyer et al., 2014). This rationale seems to hold when dealing with pervasive institutional inefficiencies, which can be predictable and comprehensible for firms. However, when facing arbitrary institutional inefficiencies firms are confronted with high uncertainty and constant change in the institutional environment. Uncertainty and change require firms to act quickly, altering their strategies and giving strategic responses to better adapt to change. It is difficult for firms to do quick strategic responses when having a local partner because of the need of negotiations with this partner (Anderson & Gatignon. 1986). When firms choose to have higher degrees of ownership they also choose to have more freedom and be able to perform strategic responses more rapidly (Chen, 2008).

The post-hoc results indicated that the effects of pervasive and arbitrary institutional inefficiencies are not the same for every facet of the institutional structure. While regulatory inefficiencies and infrastructure inefficiencies have effects that agree with the whole construct, political institutional inefficiencies did not show any effects. This can be explained because firms may use weak political institutions to influence regulations and decisions to

their favor, bypassing the inadequate institutions using their influence on government (Cuervo-Cazurra, 2008) not being impacted by political inefficiencies directly.

This study has a contribution to the international business/strategy literature in two main areas. First, I develop the concept of arbitrary and pervasive components of institutional inefficiencies; thus extending previous studies that have exclusively looked at corruption. Perhaps more interesting, I provide a new dimension of institutional inefficiencies that can be used in further studies to analyze how the uncertainty regarding the institutional structure affects strategies and operations of firms. This is also a contribution to an institution-based view by providing a dual form of analysis of institutional inefficiencies that can be used to further investigate nuances in the institutional milieu.

A second contribution to understand ownership, and ownership in cross-border acquisitions. I bring to light the effects of pervasive and arbitrary institutional inefficiencies in ownership acquired in CBAs. The results indicate that the effects of pervasive and uncertain institutional inefficiencies have opposite natures. While pervasive, generalized and pervasive institutional inefficiencies do have a negative effect on ownership, the uncertainty regarding these inefficiencies has a positive impact that influences firms to acquire higher levels of ownership. I contribute by explaining how the different types of perceived risks regarding the institutional structure will influence firm strategy in CBAs.

2.5.1 Limitations and future research avenues

This study has two limitations that I can point. First, data on WBES regarding the institutional inefficiencies can only be obtained in issues of specific years. I composed the metrics using full data since there is no data for many of the years of acquisitions that are in the sample. Further studies could use datasets of institutional inefficiencies that are not static in time, having per-year data. Hence, it would be possible to investigate institutional change and have a more accurate metric of institutional inefficiencies.

The second limitation in the study is regarding the sample. I used only acquisitions that were undertook by firms from outside of Latin America, targeting Latin American firms. Hence, it is not possible to draw conclusions about the extent of the effects of pervasive and arbitrary institutional inefficiencies in developed countries. Future studies could use data on developed countries to compare effects of institutional inefficiencies on CBAs. Latin America is an adequate context due to the differences in institutional development on it, but using data

of developed countries would make it possible to analyze the full effects of institutional inefficiencies on CBAs.

This chapter opens some opportunities for future research. First, future research could look into the impact of pervasive and arbitrary institutional inefficiencies on other aspects of firms. Pervasive and arbitrary corruption has been shown to be linked to firm strategy (Uhlenbruck et al., 2006), performance (Petrou, 2014), government relations (Lee & Oh, 2007), and FDI flux (Cuervo-Cazurra, 2008; Ferreira et al., 2016). Research using the duality of other institutional inefficiencies could also investigate the effects on these variables.

Future research could investigate the antecedents of the institutional components. The extent of economic development, pro-market reforms and aspects of culture could have different impact on pervasive and uncertain institutional inefficiencies. Hence, a stream of research could observe the dynamics between different cultural traits, economic and political developments with the pervasive and uncertain institutional inefficiencies.

The two components of institutional inefficiency measurements have the potential to bring important contributions to IB and institutional theory. The different effects of these measures on ownership decision raises more questions than answers about how much current theory can explain of how institutional inefficiencies shape ownership decisions. I call for the attention of researchers to look into these two components of institutional inefficiencies when analyzing the institutional structure and the effects of it in firm strategy and firm operations.

3 CHAPTER 3: INSTITUTIONAL DIFFERENCES BETWEEN REGIONS WITHIN A COUNTRY AND OWNERSHIP DECISIONS IN CROSS-BORDER ACQUISITIONS

The choice of ownership structure that multinational corporations (MNCs) undertake in cross-border acquisitions (CBAs) is a strategic decision based on the range of possibilities pertaining to control, resource allocation and knowledge access (Chen, 2008). Local institutions are determinant for MNCs' international strategies (Meyer et al., 2010) and MNCs will allocate more equity in CBAs that take place in countries with favorable institutional contexts (Woodcock et al., 1994; Contractor et al., 2014). However, while we understand well that institutions develop differently across countries and that different countries have different institutions (North, 1990), we have but a poor understanding of how the sub-national institutional differences matter and how they may, for instance, determine MNCs' ownership decisions (Beugelsdijk & Mudambi, 2013). This line of enquiry is especially relevant given the foundational role of an institution-based view on international business (Peng et al., 2009) and its impact on ownership decisions.

The institutional environments have received increased attention due to a focus on an institution-based view (Peng, 2002, Peng et al., 2009) particularly in emerging countries (Peng et al., 2008). Some studies have investigated the effects of the institutional context on acquisitions (Pinto et al., in press; Dow et al., 2016), ownership (Contractor et al., 2014), subsidiary performance (Brouthers, 2013; Brannen et al., 2014) and location choice (Ma et al., 2013; Lu et al., 2014) of international operations. Notwithstanding, the majority of these institutional-based studies take a country-level institutions perspective although there is a stream of research defending that countries are not homogeneous amongst their internal regions (e.g., Beugelsdijk & Mudambi, 2013; Piscitello, 2011; Goerzen et al., 2013). Themes such as subnational region variations (Dai et al., 2013), global cities (Goerzen et al., 2013) and microfoundations of spatial perception (Piscitello, 2011) have the potential to contribute to IB theory regarding how institutional environments shape ownership decisions. This study contributes to this stream of thought.

In this chapter, I follow the stream of studies proposing that institutions are different not only across countries, but also within countries' borders. That is, I propose that institutions differ across locations (cities, regions and countries) and we may identify pronounced

differences in the economic, productive, cultural, social, historic, demographic, administrative and governmental profiles of regions (North, 1990; Ghemawat, 2001; Berry et al., 2010). These institutional differences across locations refer to such issues as differences in regulations, risks and opportunities that influence an array of firms' choices, such as the ownership decisions. My purpose is thus to advance how the institutional and economic contexts are different across regions within the same country, affecting ownership decisions.

The empirical study analyzes 518 CBAs performed by foreign firms targeting Brazilian firms. I draw acquisition data from Thomson-Reuters M&A database and regional institutional framework from World Bank's Enterprise Surveys. I also use national census data to build the independent variables about agglomeration of firms and centrality of regions. The results highlight that the regional characteristics of the institutional environment are complex and hence must be taken on account. I show that institutional characteristics of a country have different effects on strategic responses than institutional characteristics of a region. Specifically, I demonstrate that the pervasive institutional inefficiencies, instead of having a negative effect on equity acquired in CBAs as showed on Chapter 2, raises ownership acquired when analyzing the regional characteristics. I also show that the centrality of the economy and the agglomeration of firms in the same industry positively influence the ownership acquired in the CBAs, while being a common destiny of investment for firms in the acquirer industry has negative effects.

This study has two contributions. First, a contribution to institutional theory by providing evidence that regional institutional variation exists. Although most research in IB theory will analyze institutional environments as country-specific, I show that there is another layer of institutional variations within the countries' border. Second, I contribute to the set of studies in International Business about the effects of institutions in ownership decisions. I provide evidence that the institutional framework of the regions also plays a role on the percentage of ownership acquired in CBAs, sometimes contradicting what would be expected of the same characteristics in nation-level. The study of regional variances in institutional frameworks can assist future research by providing a more detailed analysis of institutional framework and its effects on strategic responses of firms. Additionally, evidences that institutional frameworks vary from region to region can explain different behaviors of entry mode and location choice between regions of the same country.

3.1 LITERATURE REVIEW

Firms engaging in cross-border acquisitions will have to select the equity structure of the entry mode, this choice will impact resources and control dynamics (Stopford & Wells, 1972), learning (Chen, 2008), performance (Woodcock et al., 1994) and the overall ownership the acquirer will have over the target firm. Hence, the decision of the percentage of ownership firms acquire in cross-border acquisitions is strategic (Demirbag et al., 2007) and particularly relevant in international business (Barkema & Varmuelen, 1998). Firms are more likely to share ownership, often building a joint venture, with local firms when they need to share risks and learn to deal in the specific market (Woodcock et al., 1994).

The decision of ownership structure in CBAs is influenced by risk perceived (Woodcock et al., 1994, Brouthers & Brouthers, 2003), control (Stopford & Wells, 1972; Ferreira, 2008), need for local legitimacy (Dacin et al., 2007) and knowledge exploration (Kogut & Zander, 1993). Institutional factors have an important impact on ownership structures. Institutional quality of the environment (Meyer et al., 2009) and institutional distance (Contractor et al., 2014; Pinto et al. in press) will influence the choice between low-equity modes and high or full-equity modes. However, few studies investigate the effects of regional institutions on ownership decisions.

Institutional frameworks will affect ownership decisions. First, weak institutional frameworks will negatively influence the amount of ownership acquired in CBAs (Meyer et al., 2009). Firms will perceive more risks in countries that have weak institutional frameworks and this risk will positively influence them to choose a partnership over full equity (Woodcock, 1994). Firms will also choose partnerships when dealing with institutional frameworks that are much different than their home country's framework (Contractor et al., 2014).

Firms choose higher degrees of ownership when dealing with institutional frameworks that are strong (Meyer et al., 2009). On the other hand, firms will choose to enter with lower degrees of ownership – to have a partner – when perceived risk is higher (Woodcock et al., 1994; Contractor et al., 2014). Institutional frameworks vary from region to region and firms look at regional frameworks when deciding their strategies (Beugelsdijk & Mudambi, 2013). Hence, I propose that firms observe the regional aspects just as national aspects when choosing the degree of ownership they will acquire in CBAs. Firms will perceive institutional environments that pose threats to their operations through high criminality, low rule of law and low protection of property rights, as "weak" institutional contexts (Khanna & Palepu,

2000a) that raise risks. In order to mitigate risks and learn to deal with the regional institutional environment, firms will choose lower equity modes when regional institutional framework is weak. On the other hand, firms will perceive regions with more developed institutional framework as safer locations and choose higher degrees of equity.

Although Dunning (1998) has perceived location as an underdeveloped and neglected factor in international business, the field has received considerable attention over the last decades. Works as Ma et al. (2013), Lu et al. (2014) and Kim and Aguillera (2015) have shown that the target location studies are as important today as they were on the end of the 20th century. The institutional characteristics of location will influence firm's decisions in equity acquired in CBAs (Contractor et al., 2014, Malhotra et al., 2016; Pinto et al., in press).

At a risk of oversimplification, firms choose to internationalize with lower equity modes when facing higher risks associated with the transaction and future operations (Woodcock et al., 1994), these risks arise from the need of adapting to a new institutional environment (DiMaggio & Powell, 1983; Kostova & Roth, 2002). In an institutional view, acquisitions to countries that have greater institutional distances (Berry et al., 2010, Malhotra et al. 2016), or in countries that have weak institutional frameworks (Meyer et al., 2009) represent higher risks and adaptation costs that result in the need of a partner to learn how to deal in these environments. Researchers usually calculate institutional distance from one country to another, regardless of where in the target country the subsidiary will be installed and calculate country-level institutional quality as well (Beugelsdijk & Mudambi, 2013). However, some researchers have called for the attention to taking on account the specific characteristics of the location where the subsidiary will operate (city or region) rather than just the effects of border (see Dai et al. 2013; Goerzen et al. 2013; Piscitello, 2011). The basic assumption is that the border effects (the country-level distances and characteristics) are important, but the micro-level characteristics of the location should not be neglected (Beugelsdijk & Mudambi, 2013).

3.1.1 Institutions

Countries are essentially different in many aspects, possessing different cultures, laws, ways of living and doing businesses (North, 1990). The institutional settings have a strong impact on how firms will operate, since they need to deal with legislation, their peers and what is expected of them (DiMagio & Powell, 1983). These expectations reflect on the need for legitimacy (Suchman, 1995) and the search for legitimacy results in adaptation costs for

foreign firms (Kostova & Roth, 2002). Hence, the institutional framework may sometimes have a greater impact on FDI strategies than other more classic explanations, such as the economic environment (Kang and Jiang, 2012).

It is essential to understand the institutional systems in international business (Peng et al., 2008). As "Institutions are the rules of the game in a society or, more formally, are the humanly devised constraints that shape human interaction" (North, 1990, p. 3), firms need to take on account the institutional constraints, inefficiencies and particularities of a country in the decisions of internationalization (Chan & Makino, 2007). Consequently, the institutional context in which firms are immersed has decisive implications to the international strategies of firms (Kostova & Zaheer, 1999).

All firms are susceptible to the institutional pressures that may arise from their environment, which may lead to three kinds of isomorphism, mimetic (mimicking successful firms in search of success and legitimacy), coercive (bending through legislation pressures) and normative (professional norms and lore of doing things) (DiMaggio & Powell, 1983). Firms need to cope with these pressures in order to deal with their environment and operate properly, many times engaging in isomorphic behavior (Hillman & Wan, 2005). This isomorphic behavior is higher in contexts where the institutional environment is very different from the one in the home country and lower where the environment is more similar with the home country (Salomon & Wu, 2012). Evidences suggest that isomorphism can take decisive roles in the behavior of firms engaging in international business, commanding entry modes (Lu, 2002), financial decisions (Henisz, 2003), and legitimacy-seeking behavior (Meyer et al., 2014).

The diversity of institutional frameworks present a major challenge to firms operating overseas. Some countries have so little in common that they may present major economic disparities as different types of capitalism (Jackson & Deeg, 2008) or cultural settings that determine interpersonal relations as the behavior of executives (Lau et al., 2002). These institutional differences demand firms to shape their structures and governance setting in order to cope with each nation framework (Daniel et al., 2012).

Due to institutional inefficiencies, many constraints rise to the concerns of firms. Legal institutional inefficiencies as poor property rights, contract enforcement and flawed regulatory structures (Khanna & Palepu, 2000a) will raise uncertainty in contracts between firms. If firms do not know if their contracts with suppliers and distributors will be carried out optimally or will suffer from possible opportunistic behavior, transaction costs will rise due to this uncertainty in procuring operations and resources outside of the firm's boundaries

(Williamson, 1981). On the other hand, firms have difficulties in adapting their governance to the institutional uncertainties that are risen by volatile and weak institutional systems (Roth & Kostova, 2003). Poor formal institutions lead to uncertainty about the rule of law – and therefore uncertainty of punishment and criminal implications to opportunistic behavior – as well as informal institutional constraints lead to corruption, bribery and misconducts.

A key concept of institutional theory is legitimacy. Legitimacy is conferred by social actors (Ashford & Gibbs, 1990) and is defined as the congruency between the organization and the values and actions expected by the social actor (Pfeffer & Salancik, 1978). Firms will pursue legitimacy primarily from two social actors, the government regulators (which are represented by legislation and legal definitions) and the general public (Deephouse, 1996). There are three primary forms of legitimacy, pragmatic (which relies upon audience self-interest), moral (narrative approval) and cognitive (which follows what works and peer norms) (Suchman, 1995).

The search for legitimacy explains a great part of isomorphism (DiMaggio & Powell, 1983). Firms will mimic more traditional, successful and more legitimate firms, and will abide to industry norms, moral standards, and government legislations to be legitimate (Deephouse, 1996). Hence, the search for legitimacy can largely influence strategic choices of the firm (Pfeffer & Salancik, 1978). These strategic choices are made in order to reduce costs of adapting firms' operations to the institutional environment.

One of the key elements of international business is the border. Countries are essentially different from one another (North, 1990). Besides, Beugelsdijk and Mudambi (2013) have theorized that contexts vary broadly across regions since countries are not homogeneous within their borders and these differences have an impact on MNCs' strategies. That is, while the more commonly studied nation-level effects are very important, more attention needs to be devoted to regional-level effects on firms' strategies.

Different economic and social developments that regions have will generate different institutional contexts across regions. Regions vary greatly across each other in history (Combes, 2011), economy (Krugman, 1991; Winters, 2013) and culture (Hofstede, et al., 2010; Andersson & Henrekson, 2014). These differences will generate variations of the institutional context due to different market norms (that arise due to different economic situations and resource availability), and different government regulations (due to regional governances) resulting in different coercive and normative pressures (DiMaggio & Powell, 1983). Regions also present differences in general society, with different needs and aspirations. A slightly different society means that firms will suffer different legitimacy

pressures, since pragmatic legitimacy depends greatly of the society that the firm is directly in contact with (Suchman, 1995). Hence, pressures for legitimacy will be different across regions and adaptation costs will also be different.

3.2 HYPOTHESES

Most research that analyses institutional context uses country-level data to indicate institutional quality, framework and distance (Beugelsdijk & Mudambi, 2013). On the other hand, there are evidences that institutional systems may be slightly (or not so slightly) different from one region of a country to the other, because there are different developments in demographics (Krugman, 1991), economy (Winters, 2013), available resources (McCann, 1995), history (Andersson & Larsson, 2016) and culture (Hofsteade et al., 2010). Demographic, cultural, historical and economic characteristics influence the institutional framework (North, 1990). Hence, regions with different characteristics will have different institutional frameworks.

The institutional context is not only determined by a broad measure of overall quality. As I developed in Chapter 2, we may distinguish two facets, or dimensions, of institutional inefficiencies. First, a dimension termed as pervasive, that is characterized for being generalized, known and widespread. To some extent this refers to a set of inefficiencies that are somewhat observable even to outside agents that are less familiar with the host milieu. Second, an arbitrary dimension, that is unpredictable, susceptible to changing, or *a la carte*, arbitrary decisions of actors and surrounded by uncertainties. This refer to far less clear inefficiencies and the variability with which norms and rules are applied. Perhaps more remarkably when an institutional environment is in flux, such as that found in many Latin American countries that have been implementing pro-market reforms (Cuervo-Cazurra & Dau, 2009), even the laws change.

Pervasive institutional inefficiencies are generalized, widespread and predictable. Hence, firms will be able to set up strategic responses based on the known institutional problems that will be faced at the new location. Moreover, regional institutional inefficiencies will have a pervasive dimension as well, because there are known problems and stereotypes associated with the depth of institutional inefficiencies in regions, formed by the previous experiences of firms and general knowledge. MNCs will acquire lower amounts of equity when dealing with regional environments that have higher pervasive institutional

inefficiencies due to known risks (Henisz, 2000), and known adaptation costs for legitimacy (Meyer et al., 2014). That is, because regional environments will pose adaptation costs and risks that are higher in regions that have high pervasive institutional inefficiencies and will result in strategic responses in MNCs towards entering the environment with a local partner. Hence:

> ***Hypothesis 1***. *The extent of the pervasive institutional inefficiencies in a region is negatively related to the ownership acquired in CBAs in that region.*

On the other hand, arbitrary institutional inefficiencies are the uncertain aspects of the institutional inefficiencies. As shown in Chapter 2, this aspect is composed by the difference of the impact that the institutional inefficiencies have between firms. These differences arise from the acts of agents and the lack of homogeneity in the way that institutions work inside a country, becoming uncertainties associated with the institutional environment and the work of institutions. Arbitrary institutional inefficiencies in a region reflect the arbitrary decisions made by local governments, private corporations that are regionally so strong that can change institutions, local syndicates, or even local informal authorities (as, for instance, the mob in 20th century Sicilia).

I propose that arbitrary institutional inefficiencies will raise the amount of shares acquired. In regions that have high uncertainty about how institutions will affect firms, MNCs will prefer to have full equity to guarantee their control over the operations. Control allows firms the possibility of performing further strategic responses to counter the institutional problems, without the need of negotiating strategic changes with local partners (Chen, 2008), thus being more agile and independent strategic responses (Anderson & Gatignon. 1986). In other words, firms will be less able to determine in what extant the institutional inefficiencies, of regions with higher arbitrary institutional inefficiencies, will hinder their operations. Therefore engaging in protective behavior of full ownership (Gaffney et al., 2016). Hence, I propose:

> ***Hypothesis 2***. *The extent of the arbitrary institutional inefficiencies in a region is positively related to the ownership acquired in CBAs in that region.*

3.2.1 Economic landscapes of institutions

Economic centers and peripheries form in most countries, centers are formed by large cities with economic concentrations, on the other hand, peripheries are less economically prominent, often rural regions (Krugman, 1991). Examples are abundant. São Paulo and Mexico City are two of the most populated cities in the world since the 1900's, being economic and social centers to their nations, while other regions of their countries as the Amazon rainforest and the Chihuahuan desert are majorly unpopulated. The same applies in developed countries, the United States has the bulk of its population living in the East Coast despite having fertile land in most of its territory (Krugman, 1991) and major employment and wage differences across regions (Winters, 2013).

Urban development is the main reason for regions to become centers or peripheries (Krugman, 1991). People agglomerate in cities due to urban benefits, but are not agglomerated in only one city due to the urban costs, these benefits and costs grow with the scale of the city (Combes, 2011). Urban regions will also grow based on the consumption potential that they generate, thus attracting firms to explore the agglomeration (Glaeser et al., 2001).

Countries will have centers and peripheries, centers being social and economic hubs that connect the regions to other regions of the country and the country to other countries (Krugman, 1991). Centers result of the agglomeration of firms and resources (McCann, 1995). These centers are generally large cities that combine scale and urban benefits (as well as liabilities) that are characteristic to these cities (Combes, 2011). These centers attract firms to explore the agglomeration and its advantages (Glaeser et al., 2001). Centers are created in countries due to the agglomeration of firms and resources (McCann, 1995). The reasons for the development of agglomerations of firms in countries are basically three. The concentration of firms from the same industry in a region offers more employment possibilities to workers with industry-specific skills, this agglomeration can also support the production of specialized inputs that are not tradable, and the possible information spillovers in agglomerations can increase performance of firms in agglomerations (Krugman, 1991).The agglomeration of firms in these centers will produce an environment that leverages the human capital due to intellectual spillovers (Winters, 2013). On the other hand, as peripheries are less interconnected than centers (Goerzen et al., 2013).

The agglomerations of people and firms that centers provide will develop institutional systems that have industrial standards of cognitive legitimacy (due to the number of firms that operate there) (Suchman, 1995). The higher development of workforce due to information spillovers and the development of specific skills (Krugman, 1991) will help establish high standards for the operations of firms. These industrial standards will likely also become regulations either government or industry regulatory powers, which will increase normative and/or coercive pressures (DiMaggio & Powell, 1983) into the firms operating in these centers to obtain legitimacy (Suchman, 1995). These higher standards will reduce the risks associated with the operations of the firm, because contracts will be better enforced in stronger institutional systems (Khanna & Palepu, 2000a). Firms will view investments in economic centers as less risky, choosing towards acquiring higher degrees of ownership, while firms acquiring in regions that are not economic centers will choose lower degrees of ownership because of less developed institutional systems.

Hypothesis 3*. The economic centrality of a region is positively related to the ownership acquired in CBAs in that region.*

The microfoundations of economic differences between regions can be traced to historical antecedents. The rate of entrepreneurship in a region is path-dependent and can be rooted to a random historical event or a natural asset (Andersson & Larsson, 2016). The process of development of a place as a center also seems to be circular. Firms will prefer agglomerations due to information spillovers and the supply of industry-specific skilled workers (Krugman, 1991) which will generate human capital due to the development of the place (Winters, 2013). Human capital will attract firms and the agglomeration will grow until the costs of agglomeration overcomes the benefits (Combes, 2011). Public policy also plays a role on the creation of agglomerations, since policy-makers develop incentives to attract "talents" and lure industrial facilities (Combes, 2011).

Previous research has proven that agglomerations of firms can reduce liabilities of foreignness and also bring potential knowledge spillovers (Lamin & Livanis, 2013). Regions with high agglomerations of firms will also possess greater concentration of human capital dedicated to the specific industry that most firms of the agglomeration belong to (Winters, 2013).

Due to these advantages of agglomerations, these locations may seem a natural choice for subsidiary location (although Pouder and John (1996) have argued that only some kinds of firms prefer agglomerations). Agglomeration will seem more proper location choices to

immediate stakeholders (as employees, board members and shareholders) since they present a set of advantages to the firm, advantages that would not seem achievable outside of the agglomeration. The agglomerations of firms will produce a stronger institutional framework because firms will have more peers of their industry co-located with them, hence having multiple sources of cognitive legitimacy (Suchman, 1995). Firms will perceive these regions as less risky having better institutional frameworks and also for being places that other firms in the same industry already operate there. Hence, firms will choose higher degrees of ownership for CBAs in regions where the target firm has an agglomeration of peers from its same industry.

Hypothesis 4. *The agglomeration of firms in the same industry of the target firm in a region is positively related to the ownership acquired in CBAs in that region.*

3.2.2 Peers' attitudes towards a region

Firms often seek legitimacy in their international operations according to the institutional contexts they internationalize to (Meyer et al., 2014). Firms need to abide to the actions expected by the social actors to achieve more legitimacy (Ashford & Gibbs, 1990; Pfeffer & Salancik, 1978). One of the major alternatives for firms to achieve legitimacy is to engage in isomorphic behavior (DiMaggio & Powell, 1983; Deephouse, 1996).

Researchers have pointed some strategic choices that contribute to firm legitimacy. Dacin et al. (2007) pointed out that firms will engage in strategic alliances in order to secure legitimacy by associating with firms that are considered more legitimate. Deephouse (1996) proposes that firms will engage in isomorphic behavior looking to become more legitimate, and tested this assumption, building an empirical bridge by proving that isomorphism brings legitimacy. Bitekine and Haack (2015) propose that firms will have strategic responses to institutional change, seeking legitimacy.

Firms will imitate other successful strategies in their industry seeking to obtain legitimacy (Deephouse, 1996) and success by doing so (DiMagio & Powell, 1983). When imitating, firms will perceive their strategy as less risky than non-isomorphic behaviors. Hence, when targeting regions that are common targets of CBAs in the industry of the acquirer firm, the acquirer firms will perceive less future risks of operations because that is the normal and legitimate behavior. I propose that isomorphic behavior will have an effect

over ownership decisions so that isomorphic location choices of the acquirer firm's industry will be associated with higher degrees of ownership.

Hypothesis 5. *The number of previous peers' acquisitions in a region is positively related to the ownership acquired in CBAs in that region.*

3.3 METHOD

To test the hypotheses, I used data on CBAs collected from the Thomson-Reuters M&A dataset. I used all CBAs that had a Brazilian firm as target during the period from 2010 to 2015. I further constructed a dataset that included government provided secondary data and the World Bank's Enterprise Surveys to build the independent variables.

3.3.1 Sample

The use of Brazil for this study is appropriate for two main reasons. First, Brazil is one of the main destinies of FDI in Latin America and has been featured for years as one of the main emerging economies in the world. Hence, the institutional environment in Brazil is still in development and has regions that present more developed institutions and less developed institutions. The second reason is the fact that Brazil is a federation, having distinct variations of regulatory systems across its states, as well as very distinct cultures, economic and regulatory developments across its territory. I used the Brazilian states to represent regional units, and since Brazil is a federation every state has slightly different regulations with data that is, at least often, organized by state and then compiled to provided national statistics. Brazil also have a federal source of information called IBGE (which stands for Instituto Brasileiro de Geografia e Estatística, or in a translation Brazilian Institute of Geography and Statistics) that gathers economic and demographic data and publishes these data by state, turning data on state-level characteristics abundant.

The sample consists of 518 CBAs performed by foreign firms acquiring firms in Brazil from 2010 to 2015. I considered a period from 2010 to 2015 because data from Brazil in WBES is limited to a survey published in 2010. Nonetheless, despite the pro-market reforms underway, the institutional setting changes slowly and we may thus gain a good perspective of the specific, regional level, inefficiencies that still occur. Moreover, in selecting the sample I followed a few procedures. First, I only considered acquisitions that had data about the

specific target region or city since all the independent variables are computed at the regional level. Second, I only selected cases where the deal referred to the first acquisition. That is, in some instances a foreign MNC may acquire a partial stake and later reinforce the equity position with an additional acquisition. I excluded cases where the acquiring firm already had some degree of ownership on the target. Third, I excluded all acquisitions where the acquirer firm was registered in a tax-haven according to the Brazilian federal laws – since these might represent issues of round-tripping, following Pinto et al. (in press).

The final sample reveals some characteristics that could be expected from a study of acquisitions in Brazil. US firms were the largest acquirers in Brazil, followed by France and the UK (Table 3.1). The states that received most acquisitions were São Paulo and Rio de Janeiro, which was expected since these are the most economically prominent states of the country. The number of acquisitions by acquirer country and target state is depicted in Table 3.1.

Table 3. 1 Sample characteristics

Acquirer country	N	%	Target state	N	%
United States	221	38.04%	São Paulo	351	60.41%
France	53	9.12%	Rio de Janeiro	79	13.60%
United Kingdom	50	8.61%	Paraná	43	7.40%
Spain	38	6.54%	Minas Gerais	30	5.16%
Germany	24	4.13%	Rio Grande do Sul	22	3.79%
Switzerland	22	3.79%	Santa Catarina	12	2.07%
Japan	20	3.44%	Ceara	9	1.55%
Italy	16	2.75%	Pernambuco	8	1.38%
Canada	15	2.58%	Goiás	7	1.20%
Netherlands	13	2.24%	Brasília	5	0.86%
Portugal	13	2.24%	Mato Grosso	5	0.86%
Chile	11	1.89%	Bahia	4	0.69%
Luxembourg	9	1.55%	Amazonas	3	0.52%
Australia	8	1.38%	Paraíba	2	0.34%
Sweden	8	1.38%	Maranhão	1	0.17%
Argentina	7	1.20%	Total	581	100.00%
Ireland-Rep	7	1.20%			
Belgium	6	1.03%			
Russian Fed	6	1.03%			
Colombia	5	0.86%			
Mexico	5	0.86%			
Norway	5	0.86%			
China	4	0.69%			
Israel	4	0.69%			
Denmark	3	0.52%			
India	2	0.34%			
South Korea	2	0.34%			
Austria	1	0.17%			
Estonia	1	0.17%			
Finland	1	0.17%			
New Zealand	1	0.17%			

Source: Author's calculations with data from Thomson Reuters M&A (2017).

3.3.2 Dependent variable

The dependent variable is the ownership stake in the cross-border acquisitions of the Brazilian or foreign firm located in a given region (state) in Brazil. Ownership was assessed by the percentage of equity acquired – noting that the equity stake may vary from 5 to 100% of the equity of the target firm. I excluded acquisitions of less then 5% because these may be

speculative, short term, portfolio investments. The use of a linear measurement of ownership acquired is appropriate to the study because it captures more nuances in the data than a dummy variable for partial or full acquisitions, for instance (Chari & Chang, 2009), thus being able to capture small variances resulting from slight local variations. Data was collected from the Thomson-Reuters M&A dataset.

3.3.3 Independent variables

This study involves a number of independent variables. First, variables pertaining to the regional institutional environment. I used the World Bank's Enterprise Surveys (2009, 2010) to calculate the institutional inefficiencies for each state of Brazil. The World Bank's Enterprise Surveys (WBES) presents data on how firms operating in a given host country perceive the local institutional inefficiencies, but the survey also includes information on the regional location of the firms surveyed – that is, in the case of Brazil the state and in some occasions also the city where the firm is located. With this firm-level data it is possible to a measure of *pervasive institutional inefficiencies*. The measurement consisted (following chapter 2) in the mean of the institutional inefficiencies perceived by all firms in the state (using the same data drawn by chapter 2 single factor score). Hence this variable successfully captures the average condition of the institutional environment, that represent the inefficiencies that are pervasive, generalized, known and predictable in that state. The z-score value of the variable was used in order to normalize data.

The measurement for *arbitrary institutional inefficiencies* also followed chapter 2. I coded the arbitrary institutional inefficiencies using the standard deviation of the institutional inefficiencies perceived by the firm (calculated at the single factor score), amongst firms in the same state. Hence the measurement successfully captures the extent that the institutional is differently perceived by firms in the same state, building a measurement of uncertainty. This techniques for measuring arbitrary institutional inefficiencies also follows Jong and Bogsman (2011) in calculating arbitrary corruption. In this variable I also used the z-score value of the variable in order to normalize data.

I calculated *economic centrality* by the total number of firms operating in the state. Hence, I gathered data about the number of firms operating in each state of Brazil. For data about the states, I used IBGE Estados (2016), a government database that compiles several data from census about the population and businesses in each of the 27 Brazilian states, for

data on the number of firms operating in each state. This indicator further illustrates the economic dynamism of each state in attracting firms.

Agglomeration was coded as the number of firms in the industry operating in the Brazilian state, following Folta et al. (2006) that measured the size of the agglomeration for the specific industry the firm in the state. Data for the number of firms operating in each target state, by industry, was collected from IBGE Estados (2016). The identification of the target firms' industry is available in Thomson-Reuters M&A dataset and I used the 4-digit SIC (Standard Industry Codification) code to identify the industry of each firm and match them with the IBGE classifications.

I coded the *common destiny* variable following Xia et al. (2008) as the number of acquisitions in the target state undertook by firms of the same home-country and with the same 2-digit SIC (Standard Industrial Classification) code as the acquirer firm prior to the focal acquisition. This form of measurement captures the isomorphic behavior of the acquirer firm's industry. Data on previous acquisitions in the state was also collected from Thomson Reuters M&A dataset.

3.3.4 Control Variables

I included three sets of control variables at the firm, country and state levels. At the firm level I controlled for the *acquirer firm size* as the log dollar value of the total assets of the acquirer firm. Larger acquirer firms are also more likely to have the financial resources to engage in full equity acquisitions. Data on firm value was available in the Thomson Reuters M&A dataset. I also controlled for the acquirer firm's *CBA experience in Brazil* by calculating the number of past acquisitions that the firm had completed in Brazil before the focal acquisition, following Chari and Chang (2009). Data of the number of past acquisitions was present in Thomson Reuters M&A.

I followed Pinto et al., (in press) and controlled for the technology intensity of the acquirer and target firms using the variables *acquirer firm is hi-tec* and *target firm is hi-tec*, a dummy variable coded 1 for when the firm was high-tech intensive and 0 for when it was not, performing the same for acquirer firm and target firm. Data about the target and acquirer firms' technology intensity was retrieved from Thomson Reuters M&A.

The amount of financial resources employed in the transaction was also controlled for, following Aybar and Ficici (2009). The *transaction value* was measured as the log dollar value of the transaction to control for the amount of investment committed to the transaction, with data from Thomson Reuters M&A. The control of the transaction value is important since large acquisitions may be partial for the sheer lack of enough capital.

I followed Pinto et al., (in press) by using an *Acquirer Industry* and *Target industry* controls were coded as 1 for services and 0 for manufacture. The control of the industry is important because the type of business of the acquirer and target firms may influence the ownership decisions.

A third set of controls for the acquirer and target countries. I used *Acquirer country GDP* and *Target country GDP* as the log of the dollar value of the acquirer and target countries' GDP. I also controlled the momentary strength of the acquirer and target economies using *Target country GDP growth* and *Acquirer country GDP growth.* I used the percentage of the countries' yearly GDP growth in order to control for the economy of the acquirer and target nations, following Lahiri et al. (2014). Acquirer nations with more prominent and growing economies may have firms that are more prone to taking risks, because of a domestic market that could support possible backfires and a provide a larger pool of financial resources for firms to be able to acquire in full equity modes. Meanwhile, target countries with more vibrant economies are prone to market-seeking investments may shape equity choices. Country GDP and GDP growth are available at World Bank Data (2016).

Finally, I included a control for the target state characteristics. I controlled for the state characteristics at the time of acquisition. I included *target state GDP* of each state to control for the size and economic attractiveness of the region, data was gathered from IBGE Estados (2016).

3.4 RESULTS

In table 3.2 I present the descriptive statistics of the sample.

Table 3. 2 Descriptive statistics

	N	Min	Max	Mean	Std. Dev.
% of shares acquired	581.00	5.00	100.00	79.02	30.78
Pervasive institutional inefficiencies	581.00	-11.30	5.93	0.00	1.00
Arbitrary institutional inefficiencies	581.00	-4.55	2.30	0.00	1.00
Regional centrality	581.00	10.43	14.38	13.74	0.88
Regional agglomeration	581.00	3.85	13.36	10.77	1.57
Common destiny	581.00	0.00	109.00	25.26	29.68
Transaction value	581.00	-2.30	8.14	4.07	1.19
Acquirer firm size	581.00	-3.44	14.41	7.70	1.76
CBA experience in Brazil	581.00	0.00	14.00	0.45	1.50
Target firm is high-tech	581.00	0.00	1.00	0.49	0.50
Acquirer firm is high-tech	581.00	0.00	1.00	0.44	0.50
Target firm industry	581.00	0.00	1.00	0.35	0.48
Acquirer firm industry	581.00	0.00	1.00	0.38	0.49
Target country GDP growth	581.00	-3.85	7.53	2.15	3.31
Acquirer country GDP Growth	581.00	-4.03	10.26	1.82	1.80
Target country GDP	581.00	28.20	28.59	28.47	0.12
Acquirer country GDP	581.00	24.68	30.52	28.86	1.47
Acquirer country is developed	581.00	0.00	1.00	0.93	0.26
Target state GDP	581.00	10.07	14.52	13.36	0.94

Source: Author's calculations with research data.

In table 3.3 I include the correlations. There were no concerns regarding high correlations other than high correlations between centrality and agglomeration, which is expected since the larger the number of firms in a state, the larger will be the number of firms from the industry in that state. Hence, the two variables will not be used together to avoid multicolinearity problems. I also checked the VIF factors to assert that there were no multicolinearity problems with the other variables. Results were all bellow 5, hence being adequate to regressions.

Table 3. 3 Correlations

		1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18
1	% of shares acquired	1.000																	
2	Pervasive institutional inefficiencies	0.072	1.000																
3	Arbitrary institutional inefficiencies	-0.048	-0.629**	1.000															
4	Centrality	0.033	0.330**	-0.423**	1.000														
5	Regional agglomeration	0.137**	0.255**	-0.367**	0.776**	1.000													
6	Common destiny	-0.072	0.090*	-0.194**	0.656**	0.501**	1.000												
7	Transaction value	-0.113**	-0.056	0.036	-0.040	-0.039	-0.052	1.000											
8	Acquirer firm size	-0.089*	-0.052	0.069	0.043	0.016	0.000	0.231**	1.000										
9	CBA experience in Brazil	0.001	-0.005	0.051	-0.064	-0.014	0.043	0.057	0.271**	1.000									
10	Target is high-tech	0.253**	0.025	-0.011	0.126**	0.205**	0.200**	-0.110**	-0.109**	-0.022	1.000								
11	Acquirer is high-tech	0.331**	0.022	-0.021	0.069	0.186**	0.151**	-0.137**	-0.147**	-0.084*	0.666**	1.000							
12	Target firm industry	0.183**	0.072	-0.115**	0.013	0.305**	-0.092*	-0.009	-0.082*	-0.099*	0.255**	0.263**	1.000						
13	Acquirer firm industry	0.270**	0.063	-0.091*	0.069	0.266**	-0.095*	-0.035	-0.066	-0.144**	0.228**	0.405**	0.694**	1.000					
14	Target country GDP growth	-0.081	-0.032	0.022	0.039	-0.008	-0.063	0.029	0.114**	-0.102*	-0.018	0.001	-0.040	-0.021	1.000				
15	Acquirer country GDP Growth	-0.097*	-0.082*	0.055	-0.020	-0.020	0.067	0.070	0.164**	0.086*	-0.009	-0.067	-0.077	-0.133**	0.070	1.000			
16	Target country GDP	-0.013	0.016	-0.045	0.052	0.081	-0.005	0.005	-0.003	-0.044	-0.011	0.061	0.029	0.044	0.463**	-0.235**	1.000		
17	Acquirer country GDP	-0.008	-0.004	-0.045	0.090*	0.115**	0.111**	-0.083*	0.082*	-0.020	0.007	0.021	-0.013	0.001	-0.137**	0.184**	0.049	1.000	
18	Acquirer country is developed	0.053	0.041	-0.031	0.063	0.065	0.028	-0.114**	-0.018	-0.082*	0.052	0.080	0.032	0.076	-0.021	-0.226**	0.022	0.289**	1.000
19	Target state GDP	0.027	0.149**	-0.276**	0.826**	0.662**	0.645**	-0.037	-0.022	-0.036	0.126**	0.081	-0.022	0.034	-0.393**	-0.042	-0.117**	0.129**	0.053

Source: Author's calculations with research data.

Table 3.4 presents the results of the statistical tests of the hypotheses. Model 1 includes only the control variables. In model 2 I test hypothesis 1 on the effect of the regional *pervasive institutional inefficiencies* on the ownership. The results indicate a positive and significant effect (0.085; $p < 0.05$) of pervasive institutional inefficiencies for ownership acquired in CBAs, thus contradicting hypothesis 1 that predicted a negative effect. This result may indicate that country-level and region-level institutional inefficiencies have different effects over CBAs, since in Chapter 2 I showed that pervasive institutional inefficiencies would have a negative impact for ownership acquired. It is possible that, in cases of high regional inefficiencies firms will rather have control over their operations to be able to surpass local inefficiencies with their ownership advantages.

In model 3 I tested H2 on the influence of the regional *arbitrary institutional inefficiencies* on ownership. A not significant coefficient does not permit us to confirm the hypothesis. The lack of effect of arbitrary institutional inefficiencies in the amount of shares acquired by firms in CBAs may

On model 4 I included the *centrality* variable to test hypothesis 3. The results confirm hypothesis 3 and that firms are positively influenced to perform acquisitions of higher degrees of ownership when the region has high economic centrality (0.272, $p < 0.05$). This indicates that the institutional developments arising from the centrality of a region can make CBAs less risky, hence influencing firms to acquire more shares in their operations.

On model 5 I included the *agglomeration* variable to test hypothesis 4. The results indicate that there is a positive, significant effect of agglomeration of firms for the ownership acquired (0.188, $p < 0.001$). The result confirms hypothesis 4. It is possible that firms entering regions that have an agglomeration of firms in the same industry will perceive the institutional environment as more friendly and less difficult for adaptation, due to the development proportionated by their peers.

In model 6 I included variable *common destiny* to test hypothesis 5. Model 6 shows a negative effect (-0.136, $p < 0.01$) of common destiny on ownership acquired in CBAs. This may indicate that firms prefer partial acquisitions when performing deals in regions that are common destinies for their industry. This contradicts the predicted hypothesis 5 that would indicate a positive effect due to lower risks perceived by an isomorphic location choice. The effect may be contrary to the predictions due to two possible reasons. First, entering a common destiny implies in facing peers as competitors. Hence, higher degrees of ownership would mean a search for a partner in order to better adapt to the environment, and this

adaptation made easier by a partner would represent an advantage (or at least a leveling) against peers.

Additionally, two models were included to test the effects of the conjoint variables. Model 7 presents all variables with the exception to *agglomeration* while Model 8 has all variables with an exception to *centrality* due to the multicoleniarity of these variables. Model 7 shows only one significant effect, for the common destiny variable (-0.147, $p < 0.01$), while model 8 indicates significance of common destiny (-0.154, $p < 0.01$), and agglomeration (0.192, $p < 0.001$). These results may indicate that firms are more aware of their peers operations in a region then of the institutional characteristics of the region alone.

Table 3. 4 Regression results

	Model 1	Model 2	Model 3	Model 4	Model 5	Model 6	Model 7	Model 8
Pervasive institutional inefficiencies		0.085*					0.108†	0.077
Arbitrary institutional inefficiencies			-0.059				0.038	0.004
Centrality				0.272*			0.313†	
Agglomeration					0.188***			0.192***
Common destiny						-0.136**	-0.147**	-0.154**
Transaction value	-0.029	-0.024	-0.025	-0.029	-0.027	-0.031	-0.023	-0.017
Acquirer firm assets	-0.07†	-0.069†	-0.069	-0.074†	-0.078†	-0.081†	-0.084*	-0.087*
CBA experience in Brazil	-0.006	-0.006	-0.005	-0.006	-0.018	0.008	0.01	-0.001
Target is hitec	0.067	0.066	0.066	0.065	0.07	0.074	0.07	0.074
Acquirer is hitec	0.198***	0.2***	0.202***	0.2***	0.181***	0.21***	0.22***	0.203***
Target industry	-0.004	-0.015	-0.012	-0.012	-0.04	-0.001	-0.02	-0.048
Acquirer industry	0.161**	0.168**	0.159**	0.155**	0.155**	0.121*	0.128*	0.122*
Target GDP growth	-0.076	-0.075	-0.078	-0.187*	-0.117*	-0.063	-0.183*	-0.098†
Acquirer GDP Growth	-0.06	-0.053	-0.056	-0.053	-0.049	-0.064	-0.057	-0.055
Target GDP	0.028	0.026	0.025	0.045	0.025	0.026	0.04	0.017
Acquirer GDP	-0.015	-0.011	-0.017	-0.021	-0.039	-0.003	0.001	-0.02
Acquirer is developed	-0.025	-0.023	-0.023	-0.027	-0.024	-0.029	-0.046	-0.042
State GDP	-0.01	-0.018	-0.021	-0.285†	-0.135*	0.065	-0.244	-0.053
Adjusted r^2	0.124	0.13	0.126	0.129	0.141	0.135	0.148	0.161
Chi-square	79383	83294293	81166920	82568340	89353652	85641451	95007	101891
F	7.361	7.219	7.003	7.145	7.846	7.46	6.918	7.534
Regression p-value	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000
n.	581	581	581	581	581	581	581	581

Source: Author's calculations with research data.

3.5 DISCUSSION

In this chapter I advanced institutional theory by showing the possible effects that the institutional context of the specific region may have influencing the ownership choices in cross-border acquisitions. The main motivation for this study is the call for a more detailed explanation of the differences between regions of the same country and their impact on firm strategies made by Beugelsdijk and Mudambi (2013). It is worth noting that while IB studies have delved considerably in how countries differ and the effect of those differences on firms' international strategies (Dow et al., 2016; Brouthers, 2013; Brannen et al., 2014; Lu et al., 2014), there are substantial within country institutional differences that have remained largely unattended to.

This study brings a perspective for researchers to interpret regional institutional factors that make firms choose one type of ownership over the other. Past research has greatly debated the agglomeration effects over international subsidiaries (Lamin & Livanis, 2013) but regional differences in economic centrality and institutional factors of the region are still understudied topics. Hence, I expect this study to assist researchers to observe inner-country, or within country, institutional differences.

My main contribution is the use of institutional theory in a sense of regional analysis. Although not completely novel, a more local or regional perspective of institutional environment has been largely absent from IB research. This chapter contributes by proposing that local institutions do matter because they will shape part of the commercial interactions, along with regional norms and regulations that will influence adaptation costs. Specifically, I showed how different aspects of the regional institutional developments affects the amount of shares acquired by firms in CBAs. The results point that the effects of regional institutional characteristics are not as simple as they seem, since effects that would influence firms towards lower share acquisitions in national levels may have different and even inverse effects when dealing with regional level institutions. Altogether, the results of this chapter represent important contributions to institutional theory. First, I showed that there is more than meets the eye when regional institutions are taken on account. Institutional characteristics that would, in macro-level, result in specific strategic responses may have different and even contrary effects in micro-level. Second, I contribute by providing a view that institutions do not only meter in country-level, but also are specific to the regions.

Contrary to the expectations, national institutional inefficiencies that are pervasive shown to have a positive effect on shares acquired in CBAs. Hence, firms that acquire in regions that have higher pervasive institutional inefficiencies than other regions of the same country will often acquire higher amounts of shares. This contradicts the national effects of pervasive institutional inefficiencies that are shown in chapter 2. It is possible that, when dealing with pervasive, generalized and predictable institutional inefficiencies, firms will choose to have more control over their new operations against having a partner to learn how to operate in the environment. This may arise from a more important focus on the country-level institutional inefficiencies than regional level.

The economic setting of a region seems to have strong ties with the institutional environments and in the decision of equity acquired in CBAs. Institutional development may arise from the centrality and agglomeration of firms, reducing risks involved in the acquisition and reducing the need of a local partner to learn and adapt. This result is important because it indicates that regional characteristics that are not the institutional development *per se* but highly influence institutional development and can be determinant in strategic responses of firms in CBAs. Agglomerations will be impacted by geographic factors, since firms will more likely agglomerate near natural resources and geographic centers, economic agglomeration will also become attractive, bringing more firms to agglomerate (Winters, 2013). This study moves literature about agglomerations forward due to the indications that the agglomeration of firms has direct impact on institutions and firms decisions towards institutions.

The isomorphic behavior towards a region also showed interesting results. Common destinies where firms from the same industry are directing CBAs to that region may seem as a safer choice due to mimetic isomorphism, but it also means more competition in the target market. It is possible that, when acquiring in regions that are common destinies, firms will have a tendency of performing acquisitions of lower shares to have a local partner to help them adapt and from this adaptation advantage derive a competitive advantage against their peers.

3.5.1 Limitations and future research avenues

This study has some limitations that are important for future research. First, the various institutional facets that characterize sub-national locations (regions or even cities) are prone to be highly intertwined. For instance, geographic determinants will influence economic factors (Krugman, 1991). These economic factors will determine if the industries in that region are abundant and developed (Winters, 2013). Regions with an abundance of firms in an industry will have industry standards developed by the industry itself, as well as government regulations developed by governments concerned with these firms, Hence, the institutional environments will be different. Therefore, to gain an even clearer grasp on how each specific and individual institutional facet may drive equity in entry mode choices, more research is warranted to isolate each institutional dimension. For instance, firms may behave differently in regions where there are specific laws fostering their activity, or may even avoid some regions because of high industry standards they cannot (or rather do not want to) abide to.

Other limitation is due to the complexity of the regional institutional environment. Simon's (1965) concept of bounded rationality proposes that executives will not be rationally able to think of all factors regarding a decision. The institutional environment of a region is always a complex unity of analysis because it suffers influences from pressures of many publics (Suchman, 1995). Hence, it is not possible to generalize that decision-makers will consider all the factors that compose the regional institutional environment. Future research could use a historical approach to investigate how the decision-making process takes place when firms decide the region they will establish their subsidiaries. This research can contribute by pointing to which degree the decision is took based on careful analysis and when does it rely solely on isomorphism.

3.5.2 Concluding remarks

Differences amongst regions are due to several factors and all these factors contribute to a different outcome in MNCs strategies. It is important for researchers to not only consider border effects when studying CBAs, but also the regional effects, as these seem to be highly neglected in literature. Country and border effects are very important, but I suggest that regional effects must also be taken on account. The use of region-level data could bring some

important contributions to International Business both in theory and in empirical tests, as independent and control variables.

4 CHAPTER 4: THE PERFORMANCE OF DOMESTIC AND FOREIGN FIRMS IN INSTITUTIONALLY INEFFICIENT ENVIRONMENTS: REVISITING THE LIABILITY OF FOREIGNNESS

The rationale of the liability of foreignness is that firms' performance will be lower when operating overseas due to unfamiliarity with the host market and the added costs of dealing with the idiosyncrasies of the host country's institutional environment (Hymer, 1960; Zaheer, 1995; Eden & Miller, 2004; Nachum, 2010). While, the original studies largely referred to developed multinationals entering other developed countries (Hymer, 1960) it is likely that the characteristics of the host environments and the sources and magnitude of the added costs may differ. Operating in institutionally ineffective and inefficient institutional environments of emerging economies may raise the hazards of foreignness.

Received wisdom based on the institution-based view and liability of foreignness points to foreign-owned firms facing disadvantages compared to their domestic counterparts in such issues as informational costs of operating in a country (Zaheer, 1995), where different laws, government policies, languages and cultures, economies and income profiles are hazardous for foreign firms (Kostova & Zaheer, 1999). Due to these differences, foreign firms incur in additional adaptation costs to obtain legitimacy in the local market (Lu, 2002). However, there have also been some insights advocating that foreign firms may possess firm-specific, or ownership, advantages that help them overcome the added costs, such as costs of adaptation, entailed in liabilities of foreignness (Oetzel & Doh, 2009; Nachum, 2010). That is, foreignness can sometimes be an asset to overcome institutional problems, rather than a liability (Oetzel & Doh, 2009; Nachum, 2010). Stated differently, it is possible that, at least in some instances, foreign firms may perform better than purely domestic firms.

In this chapter, my fundamental proposition is that an underdeveloped institutional environment creates barriers for both domestic and foreign firms that foreign firms can overcome in the host institutional environments, thus outcompeting their domestic counterparts. In institutionally inefficient and unfamiliar environments, the ability to use the pool of resources to gain an advantage may be jeopardized. This is a fundamental issue in international business studies and for the theory of the multinational since it questions the

extent to which the MNE is able to leverage its distinguishing characteristics in international competition in institutional inefficient environments. Specifically, I advance the possibility that, rather than being a liability (Zaheer, 1995), foreignness may actually entail a set of advantages that only larger domestic firms – firms holding possibly scale and scope resources they control – and domestic firms affiliated to business groups may outcompete. That is, domestic firms need to pool scale and scope resources to overcome the institutional inefficiencies and outcompete foreign firms.

In this study, I propose, and empirically test, that the foreign status can give firms an advantage rather than a liability when operating in Latin America. I contrast foreign and domestic firms' performance in Latin American countries that are characterized by a number of institutional inefficiencies (Stal & Cuervo-Cazurra, 2011) and voids to which foreign multinationals are especially ill prepared to cope with. In developing regions, institutions are inherently flawed (Cuervo-Cazurra & Genc, 2008; Peng et al., 2008) even if some countries and regions are gradually developing towards a more market-based institutional structure (Meyer, 2001). I further present the mechanisms put forward by domestic firms to compete with their foreign counterparts. I specifically propose that the sheer ability to hold, or at least access, the resources needed to overcome the local institutional inefficiencies will determine whether local firms will have lower or higher performance than foreign firms, thus setting boundaries for the liability of foreignness effect. Hence, the overarching research question entails understanding how domestic firms compete against their foreign counterparts in Latin America.

The setting of Latin America is privileged for this study since the many institutional idiosyncrasies and inefficiencies (Khanna & Palepu, 2000a; Cuervo-Cazurra & Dau, 2009), could be perceived as major hazards for foreign firms and where a liability of foreignness could be especially felt vis a vis the domestic firms. Moreover, there is no evidence on the integration of Latin American based firms in the global value chains. That is, it is unlikely that, for instance, foreign firms will locate in a Latin American country to augment their knowledge-based competences, and hence most likely locating in Latin America has a local market-seeking motivation (Zhang, 2001). Additionally, Latin America has significant variations in institutional and economic developments amongst its countries, presenting a milieu of distinct environments. To test the hypotheses I used a dataset of 3,666 firms operating in Latin America retrieved from the World Bank's Enterprise Surveys (WBES). The measure of performance seeks to capture specifically firms' market performance in the host Latin American country.

I contribute to the international business (IB) theory proposing, and testing empirically, that foreign-owned firms may actually have an advantage vis a vis domestic firms operating in institutionally inefficient environments. The findings confirm that foreign-owned firms and international partnerships between a local and a foreign partner perform better than purely domestic firms in Latin America do. This is evidence that contrasts to the liability of foreignness since I show that foreign ownership entails additional advantages in dealing with the institutional environment, or that buffer them from the local inefficiencies. Moreover, it may be that domestic firms do not have a disadvantage per se or that they do not have a local embeddedness advantage. It is in understanding that local firms also suffer from a difficulty in operating in institutionally adverse conditions that they are able to overcome the local barriers by pooling both scale and scope complementary resources that are critical for operating in institutionally inefficient environments. Larger and business group affiliated domestic firms can also surpass local institutional inefficiencies and compete against their foreign peers.

4.1 THEORY AND HYPOTHESES

When Hymer (1960) referred to the costs of doing business in a host country that multinationals faced when expanding internationally, he was pointing to the competitive disadvantages of foreign *vis-a-vis* domestic firms. These disadvantages were due to unfamiliarity with the institutional environment of the host, information asymmetries, lack of local embeddedness with the local stakeholders, or lack of legitimacy, exposure to exchange rate risks, cultural factors such as patriotic feelings rejecting foreign firms, and so forth. Zaheer (1995) coined this disadvantage as “liability of foreignness” (LoF) that essentially refers to the costs and hazards firms face when operating abroad, arising from the unfamiliarity with the host institutional environment and the need for coordination across geographic distance. The development of the LoF concept spurred IB research not only in conceptualizing what it is about (Mezias, 2002; Zaheer, 2002), the factors that increase or decrease the extent of LoF (Calhoun, 2002; Zaheer, 1995, 2002; Zaheer and Mosakowski, 1997) but also how firms could overcome those disadvantages (Bell et al., 2012; Luo & Mezias, 2002; Sethi & Guisinger, 2002; Zaheer & Mosakowski, 1997). Perhaps the LoFs are only perceptible when comparing foreign with domestic firms (Zaheer, 2002) because the crucial component, that is to a large extent also definitional, is that those added costs and hazards for foreign MNCs are not incurred by domestic firms (Zaheer, 1995, 2002).

Zaheer and Mosakowski (1997) proposed that LoFs tended to decrease as foreign firms accumulate experience – for instance, the extent of multinationality helps reduce the LoF (Sethi & Guisinger, 2002). That is, gradually, foreign firms will become more embedded and legitimate in the local networks, less subjected to discrimination by local stakeholders, the government or governmental agencies, and get to know the host institutional milieu. Conversely, insufficient knowledge of the host country's culture, norms, values, and business practices (Meyer et al., 2009), greater organizational costs for internal and external transfers (Boeh & Beamish, 2012), lack of embeddedness in the local supply networks (Eden & Miller, 2004), cultural distance between the home and host countries, all raise the LoF.

Despite extant research showing evidence of the liability of foreignness (see Zaheer & Mosakowski, 1997; Mudambi & Zahra, 2007) there is some evidence and arguments on the possibility that, at least in some instances, foreignness can have advantages that compensate for the liabilities. Oetzel and Doh (2009), for instance, observed the effects of foreignness on firms operating in emerging markets and criticized the liability of foreignness assumption that foreign firms perform worse than domestic firms due to information costs. Nachum (2010) added that foreign affiliates may outperform their local counterparts because of different sets of costs and advantages originated by the multinational status. The inconclusive evidence may originate in that much of the prior research was conducted in developed countries (e.g., Zaheer, 1995; Mezias, 2002) while different results may be found in emerging countries due to different business environments.

4.1.1 Institutional environment and firms' performance

Firms' performance has been an important topic in many streams of International Business (IB) studies (Collins, 1990; Buckley, Clegg & Wang, 2002) as scholars delve into how well firms do in their foreign operations. In this vein, several studies have scrutinized the impact on performance of an array of home and host countries features (Collins, 1990), the impact of psychic distance, or the different mindsets between host and home countries (Evans & Mavondo, 2002), the extent of business relatedness of the foreign operations (Tang & Rowe, 2012), international coherence (Celo & Chacar, 2015), the institutional development of the host country, among many others. Entering foreign countries exposes firms to environments that differ from the home country in such matters as government, laws, languages, education, taxation, and economy with higher information costs for foreign firms

(Hymer, 1960). These differences and the associated costs are foundational to the concept of liability of foreignness Institutional distance, information asymmetry, unfamiliarity, and cultural differences (Bell et al., 2012) are possible sources of liabilities of foreignness that negatively influence foreign firms' performance.

Firms have to deal with the host-country institutional environments, which shape firm interactions (North, 1990). Developed institutional environments guarantee efficient market interactions (Meyer, 2001) and are crucial to the operations of firms. When institutions are developed, firms are assured that contracts will be enforced, reducing uncertainties and transaction costs (Meyer, 2001). Environments that have institutional structures that work well will also have better protection of property and intellectual rights (Khanna & Palepu, 2000a) making possible for firms to adapt more easily and gain legitimacy (Wright et al., 2005). Hence, firms will face lower levels of uncertainty regarding their operations. Because of the better structure for their operations, firms will likely have better performance when operating in institutionally developed environments that protect exchanges (Peng & Luo, 2000).

However, when the institutional environment has flaws and does not assure safe and predictable transactions, firms will suffer. For instance, institutions in transition economies and emerging markets are still developing towards a market-based structure and have several voids and inefficiencies (Khanna & Palepu, 2000b). The lack of effective enforcement in contracts has been identified as one of the main sources of stagnation for underdeveloped countries (North, 1990). The lack of well-established and enforced regulations also raises the uncertainties regarding how firms can obtain legitimacy, making adaptation processes more difficult (Ferreira & Serra, 2015). Moreover, when institutions are underdeveloped, institutional voids may be filled by alternative institutions (Khanna & Palepu, 2000b). For instance, the lack of market-based institutions in China during the decades before its economic growth gave place to the importance of a relationship-based interaction that remains up to today (Hermann-Pillath, 2010). Hence, firms may have to deal with specific institutions that are unlike others found in institutionally underdeveloped countries. As these alternative institutions have costs of legitimacy, they will also have a negative effect on firms' performance.

4.1.2 The performance of foreign-owned firms

When comparing the mechanisms that influence foreign and domestic firms' performance, a prevailing argument is that foreign firms make adaptations to gain legitimacy (Guisinger, 2001). Most international business research incorporates legitimacy and adaptation costs as part of the construct of LoF. These are indeed components of LoF, but general interpretation may overestimate the effects of adaptation costs to foreign firms while underestimating the costs of obtaining legitimacy for domestic firms. Domestic firms are not, just as foreign firms, innately legitimate (Suchman, 1995). Although probably more knowledgeable of their home environment than foreign firms, perhaps more especially the cognitive and normative aspects of it, domestic firms may not always be more legitimate than foreign firms, just as not better performers.

Normative and cognitive institutions are more easily dealt with by local firms, because of their knowledge of the environment (Kostova & Roth, 2002) having no need to adapt the way they do business in order to gain legitimacy. On the other hand, foreign firms are able to choose the location in which they will invest, selecting locations that will have institutional environments that can be coped with (Bevan, 2004). Foreign firms can also have advantages from multiple embeddedness, overcoming local institutional idiosyncrasies by drawing knowledge from their international operations (Meyer, 2010).

Foreign firms have an information advantage since operating in multiple countries they have better access and better capability to process information (Nachum, 2010) thus being able to better adapt to the institutional environment and institutional changes of the local country. While domestic firms, in their majority, have only dealt with their local institutions, MNCs can use their information advantages from multiple experiences to overcome local problems. Hence, MNCs can use the knowledge generated in international operations to better adapt to the local institutional environment devising strategies from the diversity of contexts to overcome local problems (Meyer, 2010).

MNCs have advantages related to their international status that can outfit from their pool of human resources. Firms can use expatriates that have dealt with institutional inefficiencies in other countries in order to gather information and knowledge to adapt the firm to the local context (Gaur et al., 2007; Björkman et al., 2008). Domestic firms, on the contrary, have only information of their own environment and hence may be better suited to perform on it, but less able to respond to institutional changes.

In sum, while the liability of foreignness determines that, when everything is controlled for, foreign firms will perform worse than their domestic counterparts, I argue that in the Latin American countries we ought to observe the host countries institutional inefficiencies and market inefficiencies that render foreign-owned firms a number of potential advantages. While I do not deny there is additional information costs to foreign firms, I argue that the inefficient institutional environment affects both foreign and domestic firms. Hence, MNCs are likely to make use of strategic responses based in multiple embeddedness (Meyer, 2010), bargaining power with local governments (Head & Ries, 1996), knowledge from international operations (Regner & Zander, 2014), pool of human resources (Björkman et al., 2008) to be able to overcome the information costs about local institutions. Additionally, these strategies will not only make MNCs overcome information costs but also can be used to surpass institutional inefficiencies. These strategies are not available for local firms as they can only count with their indigenous knowledge of the institutional environment. As institutional inefficiencies will reduce firm performance because of additional costs that they implicate (Meyer, 2001), these costs of adaptation for legitimacy (Suchman, 1995) are for both foreign and domestic firms. While domestic firms know how to operate in this environment, MNCs have advantages to overcome the inefficiencies of the institutional environment, hence performing better than purely domestic firms.

> ***Hypothesis 1****: Foreign ownership is positively related to firms' performance in institutionally inefficient countries, such that foreign-owned firms will have superior performance compared to domestic firms.*

4.1.3 The performance of foreign-domestic partnerships

Zaheer's (1995) liability of foreignness is largely based in the unfamiliarity of foreign firms with the host institutional environment and the restrictions imposed by local governments. In the previous hypothesis I built arguments indicating that MNCs can outperform their local peers by using their multinational advantages to overcome the lack of local knowledge and also perform better against institutional inefficiencies. However, when firms are not completely foreign nor completely domestic, other mechanisms may arise. That is, firms may not be fully foreign-owned but still have some degree of foreign ownership, such as partnerships and partnerships in general. Partnerships with local firms seem to be a fit entry mode for foreign firms to operate in less developed institutional environments.

Partnerships combine the ownership advantages possessed by foreign firms, as access to resources, information (Nachum, 2010) international knowledge (Oetzel & Doh, 2009), multiple embeddedness (Meyer, 2010) and international pool of human resources (Björkman et al., 2008). On the other hand, the domestic part of the partnership will grant access to knowledge of the institutions and "rules of the game" (Peng et al., 2008), as well as access to political ties linking corporate managers to government officials (Liu, Wang & Zhang, 2013). The possible preferential treatment (Voss et al., 2009) and privileged information (Brockman, Rui & Zou, 2013) granted by political ties, as well as the institutional experience held by the domestic firms make way for foreign-domestic partnerships to explore ownership advantages avoiding information costs. Hence, foreign-domestic partnerships, even with low equity participation of foreign or domestic capital, will have a broader access (not necessarily ownership, but rather access) to resources, information and knowledge, leveraging these advantages can lead partnerships to better adapt to inefficient institutional environments and sustain better performance against their purely domestic firms.

> ***Hypothesis 2****: Joint foreign and domestic ownership is positively related to firms' performance in institutionally inefficient countries, such that foreign-domestic partnerships will have superior performance compared to domestic firms.*

4.1.4 Moderating effects on domestic firms' performance

MNCs may also use their larger size, resource endowments and possibility to extract economies of scale to leverage their competitive advantages and outperform host-country firms (Oetzel & Doh, 2009). MNCs are also likely to benefit from scope advantages of product diversification (Tallman & Li, 1996). Scope and scale of MNCs creates jobs and moves the economy, which can result in bargaining advantages with government institutions. Governments can give incentives and tax reductions in order to secure jobs that large MNCs can provide (Head & Ries, 1996), domestic firms on the other hand have lower bargaining power against institutional decisions of the government since they usually cannot choose a country to locate.

As argued in the prior hypotheses, domestic firms would be less competitive than foreign firms because they are more susceptible to the institutional inefficiencies of their home country. The question is thus how can domestic firms outcompete their foreign counterparts. Domestic firms may not have identical ownership advantages, resources and

information, to foreign firms and foreign-domestic partnerships, but domestic firms can compensate in other fields. By pooling together scale and scope resources they may be able to, at least in part, compensate for a lesser resource endowment. Larger firms can better exploit scale economies and rely more on their own capacity of developing knowledge rather than abortive capacity (Mowery et al., 1996). Moreover, larger firms are better able to build synergies among their resources and activities to overcome institutional inefficiencies and achieve greater performance (Wu et al., 2006). For instance, they may be able to conduct investments in logistic infrastructure that are not available. An example is Vale, the Brazilian mining company, that built its own railroad to take ore from the mines to the seaport, overcoming an infrastructure void.

As larger domestic firms can have access to more resources through their financial abundance, can better develop their knowledge and better leverage their achieved resources in order to compete against foreign firms in their country, using their size to compensate for the access to resources and overcome institutional inefficiencies they face in their own home market.

> ***Hypothesis 3****: Firm size strengthens performance of domestic firms, such that large domestic firms will have a superior performance against their foreign-owned and foreign-domestic partnership counterparts.*

An alternative for firms to be competitive against their international adversaries is to create, or affiliate to, business groups. Business groups are complex organizations with heterogeneous resources (Garg & Delios, 2007) which can contribute positively to several aspects of a firm. Khanna and Rivkin (2001, p. 47) define a business group as "a set of firms which, though legally independent, are bound together by a constellation of formal and informal ties and are accustomed to taking coordinated action". Firms belonging to business groups have been shown to have better performance in developing countries (Chang & Choi, 1988, Khanna & Palepu, 2000b). Being affiliated to a business group also helps firms bend institutions, politics and gain influence due to closer ties to the power (Fields, 1995: Pinto et al., in press) and ultimately overcome institutional inefficiencies.

Affiliation to business groups provides domestic firms with broader access to a pool of scale and scope resources that can help domestic firms overcome institutional inefficiencies of their environment. That is, business group affiliation is an alternative strategy to internal growth. A domestic business group affiliated firm will have both the access to resources provided by the siblings in the business group and the power to bend local institutions

(particularly in Latin America, where institutions are weaker) therefore mitigating existing disadvantages.

> ***Hypothesis 4****: Business group affiliated domestic firms will have greater performance, such that domestic firms affiliated to business groups will have superior performance against their foreign-owned and foreign-domestic partnership counterparts.*

4.2 METHOD

4.2.1 Data and sample

To test the hypotheses, I constructed a dataset of local and foreign firms operating in Latin America, based on World Bank's Enterprise Surveys data (WBES). The unit of analysis is the establishment and I include purely domestic firms, foreign firms and firms with a mix of foreign and domestic capital, named *partnerships.* I constructed the data using all firms present at WBES from the 18 Latin American countries. Latin American countries are a good context to empirically test the hypotheses for two main reasons. First, these countries have acknowledged adverse institutional conditions (Cuervo-Cazurra & Dau, 2009). These institutional insufficiencies make Latin America a good setting to observe the effects of a liability of foreignness but also the possible advantages that foreign firms may hold. Second, Latin American countries have made substantial progress towards creating more market-based economies (North, 1990; Bruton et al., 2009). Latin American countries have endeavored into an array of pro-market reforms entailing privatization, trade liberalization and market openness that have at least to some extent created an *emergingness* status of Latin American countries, making them more suitable to domestic and foreign investments as well as a birthplace for multinationals (Cuervo-Cazurra, 2007).

The Latin American institutions are gradually mutating towards a more free market (Bruton et al., 2009) following the pro-market reforms that have been underway (Cuervo-Cazurra & Dau, 2009). Latin America has been undergoing a gradual process of transition towards a more liberalized economy. The liberalization process (especially the lowering of international trade barriers) dismantles the protective regulations that shielded domestic firms against their foreign, more resourceful competitors. Hence, the changes in institutional environment hindered the advantages that domestic firms had, while foreign firms were encouraged to enter Latin American countries.

The WBES is a reliable source of data on the ease and difficulties of doing business in various countries around the world and used in prior studies (Jensen et al., 2010; Hope et al., 2011; Lamin & Livanis, 2013). WBES observes establishment-level data, considering that "for the purposes of this survey an establishment must make its own financial decisions and have its own financial statements separate from those of the firm. An establishment must also have its one management and control over its payroll" (WBES Questionnaire Manual, 2011). Hence, all data was deflated to the level of the establishment and firms are independent (for instance, they are not part of a franchise chain). Selecting only the Latin American countries, the sample comprises 3,666 firms operating in 18 Latin American countries, including South America, Central America and Mexico.

I classified the firms in the sample as *foreign-owned* when they had 95% or more of their equity owned by foreign firms, foreign-domestic *partnerships* when the firm had any combination from 5% to 95% of domestic and foreign equity, and finally, domestic for firms whose equity had less than 5% of foreign ownership. Firms reported as part of a group were labeled as affiliated to a *business group*. It is important to note that, in the sample, most firms that are affiliated to business groups are domestic, while there are few foreign firms affiliated to business groups. The majority of domestic firms is predictable since business groups are traditionally an emerging market strategy (Singh et al., 2007; Castellacci, 2015). Table 4.1 shows the number of firms in the sample by country, foreignness and business group affiliation.

Table 4. 1 Description of sample

Country	N. of firms in sample	Domestic firms	Partnerships (foreign-domestic)	Foreign firms	Affiliated to Business Group
Argentina	384	326	17	41	106
Bolivia	19	18	0	1	5
Brazil	559	521	22	16	121
Chile	451	421	16	14	71
Colombia	351	344	5	2	3
Costa Rica	115	93	5	17	17
Dominican Rep.	59	43	4	12	3
Ecuador	74	60	8	6	8
El Salvador	50	38	6	6	12
Guatemala	159	142	5	12	7
Honduras	30	26	2	2	1
Mexico	785	710	38	37	150
Nicaragua	20	18	0	2	3
Panama	14	14	0	0	1
Paraguay	32	32	0	0	4
Peru	394	341	35	18	66
Uruguay	138	124	6	8	11
Venezuela	32	28	2	2	7
Total	3,666	3267	118	235	596

Source: Author's calculations with data from World Bank's Enterprise Surveys (issues from 2009 and 2010).

4.2.2 Variables and measurements

4.2.2.1 Dependent variables

I used data present in the WBES in order to determine firms' local performance. Albeit a number of economic and financial measures may be used to assess firms' *performance*, I used a measure of sales over assets (see Bernolak, 1997; Hendricks & Singhal, 2008). This measurement is calculated by the value of sales (which includes national sales, direct and indirect exports) divided by the firms' assets. Data was in local currency and was converted to USD using the dollar value in relation to the local currency on December 31st of the respective year. I further transformed the dependent variable by its natural logarithm to deflate the values and normalize the data (Duysters & Hagedoorn, 2001). The specific focus on how firms perform in a given host country renders that an arguably better procedure is to isolate the performance of the focal establishment from the remaining subsidiaries, and hence

a measure of how firms perform in a given host country seems to provide a better fit in this study.

4.2.2.2 Explanatory variables

My main exploratory variable is the ownership structure of the firm. Firms' ownership distinguishes if the firm is *domestic*, *foreign* or a *partnership*. I measured ownership structure using three dichotomous variables. Firms with 95% foreign capital or more were considered *foreign* (one for foreign-owned firms, zero otherwise), firms holding less than a 5% foreign equity stake were considered *domestic* (one for domestic firms, zero otherwise). I further coded as international *partnership* those firms that had some combination of domestic and foreign-owned equity between 5% and 95%, also using a dummy variable coded as one for *partnership* and zero otherwise. Data about firms' ownership structure was retrieved from WBES and I excluded firms that had no information about their ownership structure.

Two variables capture the moderators that help firms deal with the institutional inefficiencies and influence the relationship between ownership structure and performance. *Business group affiliation* was coded dichotomously attending to whether the focal firm was affiliated to a business group. Business group affiliation grants firms diversification in resources (Singh et al., 2007) and the possibility of dealing better with institutional voids (Khanna & Palepu, 2000a, 2000b). I used data indicated at the WBES survey to anchor the dummy variable as one if business group affiliated, and zero if the firm was a standalone, following Castelacci (2015).

The second moderator for the empirical study was *firm size* as a form of observing firms' scale and scope resources. As firms of larger scale will have larger pools of resources in scale and scope, which can be used to overcome institutional inefficiencies (Wu et al., 2006). I measured *firm size* by the total number of employees from the firm (Cavusgil, 1984; Evans, 1987; Calof, 1994). The total number of employees per firm is available in the WBES.

4.2.2.3 Control variables

The controls capture variations at firm, industry and country level. At the firm level, I included *financial resources* which is the sum of book value of all land and machinery owned by the firm (Huselid, 1995). Data was originally in local currency and was transformed in USD using the currency exchange rate on December 31th of the due year. Data on financial resources was obtained at WBES, I used the value's natural logarithm to normalize the data.

I used the average employees labor cost to control the *specificity* of the firm's human resources. Specificity of a firm's human resources can significantly alter its business relations

and performance due to transaction costs (Lepak & Snell, 1999). I calculated *Specificity* using total labor cost of the focal firm divided by the total number of employees of the firm, deflated by its natural logarithm because firms with employees that have higher salaries represent the use of more specific human resources.

I further added controls for *direct exports* and *indirect exports* to capture variance related to the focal firm's degree of internationalization. To calculate direct and indirect exports I used the percentage of revenue of the firm from direct exports sales and indirect exports sales, respectively. A control for exports is relevant since a firm may be export oriented, for example, many foreign manufacturing firms in Mexico are taking advantage of NAFTA provisions and producing for the US market. Data on revenue from direct and indirect exports was retrieved from WBES.

I controlled the *international legitimacy* of the firm's quality standards. The international legitimacy of the firm was measured using the existence of international certifications of quality. I coded this variable using a dummy that was coded one for if the firm had an international quality certificate (ISO 9000, for instance) and zero for otherwise. Data about international certificates of the firm is available in WBES.

The final firm level control was *foreign technology*. Foreign technology represents the use of licensed foreign technology by the firm on its' local operations. Foreign technology was measured by a dummy variable coded as one for when the firm has any licensed foreign technology in use and zero otherwise. Controlling for the use of foreign technologies may absorb variance on performance because of internationalization and international relationships in networks. Data about the use of licensed foreign technology was available at WBES.

I used the standard *industry* control, using the dummy variables for nine 2-digot SIC codes to control for industry effects. I classified industry using the main SIC code of the firm following Contractor et al. (2003). Firm's main SIC code was retrieved from the WBES dataset.

Finally, I included country-level controls. I used the total *FDI inflows* of the country. FDI inflows were measured by the total inflows of capital from foreign direct investments deflated by the GDP of the country in the focal year. The use of FDI inflows as a control is important to control for the attractiveness of the economy, because more attractive economies would also be more vibrant and mean market-seeking investments for firms. I also controlled the average total *tax burden* in commercial profits by firms in the country. This measurement comprehends the average percentage of the firms' revenues that are used to pay taxes in a country. I also controlled for the *government consumption* using the gross amount of

expenditure by government in the focal year, in millions of USD. The use of government consumption absorbs variation because in countries where the government has great consumption the very government may drive the demand. FDI, government consumption and Tax rates data were retrieved from the World Bank Database. Finally, I incorporated a standard *country* control using dummy variables to control for additional country effects.

4.3 RESULTS

Table 4.2 provides the descriptive statistics and correlations for the variables in the sample. There were no alarmingly high correlations and the VIF scores are generally low. To avoid multicollinearity problems I do not include the variables “Domestic”, “Foreign” and “Partnership” in the same regression analysis and, instead, enter them separately in different models.

Table 4. 2 Correlations

		Mean	Std. Dev.	1	2	3	4	5	6	7	8	9	10	11	12	13	14
1	Performance	0.363	1.747	1.000													
2	Foreign-owned	0.064	0.245	0.065**	1.000												
3	Partnerships	0.032	0.177	-0.009	-0.048**	1.000											
4	Domestic	0.891	0.311	-0.041*	-0.749**	-0.522**	1.000										
5	Business group affiliation	0.163	0.369	0.151**	0.239**	0.170**	-0.283**	1.000									
6	Firm size	137.289	443.561	0.030	0.205**	0.083**	-0.204**	0.314**	1.000								
7	Foreign technology	0.148	0.356	0.025	0.232**	0.098**	-0.246**	0.211**	0.151**	1.000							
8	International legitimacy	0.252	0.434	0.081**	0.246**	0.118**	-0.267**	0.420**	0.219**	0.157**	1.000						
9	Financial resources	13.759	2.276	-0.398**	0.195**	0.140**	-0.237**	0.657**	0.288**	0.184**	0.368**	1.000					
10	Specificity	8.684	1.173	0.154**	0.159**	0.058**	-0.166**	0.207**	0.171**	0.104**	0.262**	0.368**	1.000				
11	Indirect exports	2.498	10.979	-0.013	-0.007	0.023	-0.013	0.076**	0.011	0.028	0.080**	0.068**	0.022	1.000			
12	Direct exports	8.807	21.380	0.072**	0.263**	0.140**	-0.284**	0.437**	0.149**	0.158**	0.368**	0.348**	0.216**	0.005	1.000		
13	FDI inflows	54.608	125.326	0.143**	-0.013	0.036*	-0.026	0.001	0.022	-0.019	0.057**	0.008	0.222**	-0.016	0.044**	1.000	
14	Tax burden	53.722	23.301	0.021	0.022	-0.044**	0.000	-0.039*	0.034*	0.000	0.018	-0.020	0.068**	0.031	0.014	-0.307**	1.000
15	Government consumption	175.685	94.237	0.203**	-0.033*	-0.007	0.052**	-0.046**	-0.017	-0.025	0.066**	-0.125**	0.113**	0.021	0.011	0.084**	0.440**

Source: Author's calculations with research data.

To gain a better grasp of the actual data, table 4.3 presents the means for the variables for each type of firm - foreign, partnerships and domestic firms – and also for firms affiliated to business groups. This data illustrates some characteristics of the sample, namely that foreign-owned firms and partnerships seem to have better average performance than domestic firms. Firms affiliated to business groups tend to have a larger number of employees than the average firms in the total sample. Moreover, firms affiliated to business groups seem to generally perform better than those that are not affiliated.

Table 4. 3 Means by firm type

	Foreign Firms	**Partnerships**	**Domestic firms**	**Affiliated to Business Groups**	**Total Sample**
Performance	0.81	0.26	0.34	0.36	0.36
Foreign-owned	1.00	0.00	0.00	0.15	0.06
Partnership	0.00	1.00	0.00	0.10	0.03
Domestic	0.00	0.00	1.00	0.75	0.89
Business group affiliation	0.45	0.36	0.14	1.00	0.16
Firm size	288.36	498.11	109.61	364.73	137.29
Foreign technology	0.47	0.36	0.12	0.27	0.15
International legitimacy	0.65	0.56	0.21	0.47	0.25
Financial resources	15.30	15.77	13.56	15.36	13.76
Specificity	9.22	9.05	8.63	9.06	8.68
Indirect exports	3.67	2.63	2.42	2.31	2.50
Direct exports	28.38	23.12	6.90	12.04	8.81
N	235	118	3267	596	3666

Source: Authors' calculations with research data.

Table 4.4 reports the results of the multivariate regressions testing the hypotheses. The dependent variable assesses firms' performance in the local Latin American countries. Model 1 includes only the control variables. Models 2 to 6 test the hypotheses separately and model 7 is the complete model – noting that in the estimation I have used only domestic firms given the correlation to the other types of firms (foreign-owned and partnerships).

Table 4. 4 Regression results

	Model 1	Model 2	Model 3	Model 4	Model 5	Model 6	Model 7
Foreign-owned		0.049***					
Partnership			0.017				
Domestic				-0.054***	-0.076***	-0.068***	-0.083***
Firm size					0.087***		0.088***
Business group affiliation						0.025	0.024
Domestic*Firm size					0.133***		0.122***
Domestic*BG affiliation						0.074**	0.053*
Foreign technology	0.069***	0.061***	0.069***	0.06***	0.054***	0.056***	0.051***
International legitimacy	0.167***	0.161***	0.166***	0.161***	0.137***	0.152***	0.131***
Financial resources	-0.614***	-0.616***	-0.616***	-0.619***	-0.699***	-0.642***	-0.713***
Specificity	0.194***	0.19***	0.194***	0.187***	0.206***	0.183***	0.202***
Indirect exports	-0.002	-0.003	-0.003	-0.004	-0.008	-0.002	-0.006
Direct exports	0.106***	0.098***	0.105***	0.097***	0.087***	0.101***	0.09***
FDI inflows	0.033**	0.03*	0.033**	0.028*	0.032**	0.028*	0.032**
Tax burden	-0.022	-0.023	-0.021	-0.022	-0.021	-0.024	-0.023
Government consumption	0.174***	0.175***	0.174***	0.175***	0.170***	0.175***	0.170***
Industry	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Country	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Regression chi-square	5403	5427	5406	5430	5800	5524	5855
Adjusted R^2	0.477	0.479	0.477	0.479	0.518	0.487	0.517
F	84.56	83.17	80.19	82.57	90.59	82.06	88.21
Regression p-value	0.000	0.000	0.000	0.000	0.000	0.000	0.000
N	3,666	3,666	3,666	3,666	3,666	3,666	3,666

Dependent variable: firm performance in host country, measured with sales over assets in the country (log).
*** p < 0.001; ** p < 0.01; * p < 0.05; † p < 0.1.
Source: Author's calculations with research data.

Model 2 tests hypothesis 1 on the positive effect of foreign-ownership on firms' local performance and a positive and significant coefficient ($\beta = 0.049$ $p < 0.001$) confirms a positive relation. That is, foreign-owned firms tend to perform better than both domestic and international partnerships. This result shows that, having many of the other explanations controlled for, foreign firms are more able to deal with the institutionally inefficient environments, as reveled by better performance in the local market. Model 3 tested H2 on the suggested positive effect of partnerships between foreign and local partners on the performance in Latin America. Contrary to the prediction, there was no significant effect, and it is not possible to confirm the hypothesis. The lack of a significant advantage of foreign-domestic partnerships may indicate that there is an inability for foreign firms to learn with domestic firms in institutionally inefficient countries, or else, a difficulty of transferring advantages of foreignness when firms do not have whole control of the subsidiary. This is interesting since one of the usual explanations for engaging in partnerships (e.g., joint

ventures and partial acquisitions) with local firms is gaining local legitimacy and learn about the local institutions, that should lead foreign firms to perform better.

In Model 4 I tested the direct effect of the *domestic* type of ownership on firm performance. Purely domestic ownership showed strong, negative effects in local performance ($\beta = -0.054$, $p < 0.001$). In terms of the liability of foreignness prediction that foreign firms should perform worse than domestic firms when other aspects than foreignness are controlled for (Zaheer, 1995), I are revealing contrary evidence. Foreign owned firms seem to have the ability to deal with the institutional inefficiencies encountered in the Latin American countries and hence perform better than their domestic peers. Nonetheless, this outcome needs to be read with caution since the data is incomplete in dimensions such as prior experience in the focal country and in the region – experienced firms may have learned how to overcome the local constraints.

Models 5 and 6 tested the interactions. Model 5 tested H3 on the interaction between size of the domestic firms and their local market performance. A positive and significant coefficient ($\beta = 0.133$, $p < 0.001$) confirms the hypothesis that larger domestic firms perform better even in conditions of local institutional inefficiencies. Possibly, as hypothesized, larger firms have a pool of resources that they may deploy to circumvent the local voids, such as infrastructure insufficiencies, underdeveloped distribution networks, or inefficiencies in the capital markets, for instance. Larger domestic firms can invest in scale and scope strategies that leverage their possibilities of competing and performing, thus being able to cope with international competitors.

Model 6, testing H4, confirmed the mitigating effect of being affiliated to a business group on domestic firms' performance ($\beta = 0.074$, $p < 0.050$). Business group affiliation seems to provide positive implications to firms operating in emerging countries. First, firms can use business groups to cope with their poor institutional environment (Khanna & Palepu, 2000a; Pinto et al., in press). Additionally, business groups have access to privileged information and some degree of influence in politics due to government ties (Liu et al., 2013; Pinto et al. in press). Moreover, affiliated firms can access a pool of resources that they do not hold. Finally, on model 7 I added both moderation effects, showing the conjoint dynamics of both moderations.

4.3.1 Post-hoc tests

I further explored the data and results with a number of post-hoc tests. In particular, in Table 4.5 I separated the analyses according to the type of firm: domestic, partnerships between a local and a foreign firm, and foreign-owned firms. The regressions include tests for the effect of size and business group affiliation on firms' local performance.

Table 4. 5 Post-hoc analyses

	Domestic		**Partnerships**		**Foreign**	
	Model 1	Model 2	Model 4	Model 5	Model 7	Model 8
Firm size	0.21***		0.132		0.167**	
Business group affiliation		0.098***		0.078		0.085
Foreign technology	0.044***	0.045***	0.148†	0.136†	0.106*	0.113*
International legitimacy	0.118***	0.134***	0.097	0.087	0.11†	0.117*
Financial resources	-0.684***	-0.628***	-0.778***	-0.738***	-0.801***	-0.752***
Specificity	0.226***	0.202***	0.171*	0.138†	0.181***	0.132*
Indirect exports	0.002	0.007	-0.155*	-0.137†	-0.052	-0.052
Direct exports	0.088***	0.104***	0.048	0.071	0.028	0.032
FDI inflows	0.041***	0.039**	-0.004	-0.011	-0.068	-0.1†
Tax burden	-0.03*	-0.032*	0.015	0.011	0.048	0.052
Government consumption	0.164***	0.171***	0.126†	0.109	0.19***	0.195***
Industry	Yes	Yes	Yes	Yes	Yes	Yes
Country	Yes	Yes	Yes	Yes	Yes	Yes
Regression chi-square	5276	5009	297	295	367	358
Adjusted R^2	0.533	0.506	0.544	0.536	0.505	0.489
F	91.972	82.579	5.088	5.229	8.218	8.687
Regression p-value	0.000	0.000	0.000	0.000	0.000	0.000
N	3,267	3,267	118	118	235	235

Dependent variable: firm performance in host country, measured with net sales in the country.
*** $p < 0.001$; ** $p < 0.01$; * $p < 0.05$; † $p < 0.1$.
Source: Author's calculations with research data.

The post-hoc tests identified that the positive moderator effect of size was significant for both foreign and domestic firms, while not significant for partnerships. This seems reasonable in the context of Latin American countries perhaps more especially because larger firms are better able to overcome the infrastructural insufficiencies. Larger firms are likely to hold not only slack resources but also complementary resources that they may deploy to overcome local shortages. Larger firms are also better able to exert political influence in their favor.

Business group affiliation on the other hand, shows a significant moderator effect – improving firms' performance in the local market - only for domestic firms, not for

partnerships or for foreign firms. This result corroborates the idea that domestic firms will use business groups to access an array of physical, financial, informational and reputational resources that are critical in operating in institutionally inefficient environments (Khanna & Palepu, 2000a). Business groups also may help firms to have a better relationship with governments, which would help firms bend institutions in institutionally inefficient countries (Fields, 1995). Nonetheless, it is puzzling that foreign firms do not enjoy similar benefits, even if to a lesser extent given they already hold internally a number of these advantages.

4.4 DISCUSSION AND CONCLUDING REMARKS

In this study I have delved into the performance of domestic and foreign firms in Latin American countries. I sought to further expand on the liability of foreignness as put forth by Hymer (1960) and tested in ensuing studies (e.g., Zaheer, 1995; Zaheer & Mosakowski, 1997; Mudambi & Zahra, 2007; Zhou & Guillén, 2015). Latin America seems to be a suitable milieu to scrutinize the mechanics of foreignness and the possible advantages, or disadvantages of foreign firms *vis a vis* local domestic firms. Although in Latin American countries institutions are gradually mutating and evolving towards a more free market (Bruton et al., 2009; Cuervo-Cazurra & Dau, 2009), there persist a number of institutional voids and inefficiencies (Khanna & Palepu, 2000a; Stal & Cuervo-Cazurra, 2011). Operating in institutionally ineffective and inefficient countries, the value of firms' resources and capabilities of firms is tested, perhaps more remarkably those resources and experiential knowledge that provide scale and scope ability to overcome the local institutional shortages. For domestic firms, increasingly subjected to foreign competition due to the pro-market reforms that are implemented, the conundrum is in how to compete and perform given the local setting. It is likely that a strategic response may be based on the need to hold, or own, or to access a pool of complementary scale and scope resources to overcome the local shortages.

Specifically, at least in the context of Latin America, the results suggest foreign-owned firms perform better than their domestic rivals. More likely, it is the ownership advantages and a large pool of resources that account for the better performance of foreign firms compared to their domestic counterparts; possibly because foreign firms are able to leverage their resources to overcome imperfect institutional systems. While contrary to the liability of foreignness rationale, this is consistent with resource and capabilities perspectives. Moreover,

while domestic firms seem to perform worse, their performance improves with size (that is, for larger domestic firms) and with business group affiliation.

Zaheer (1995) rested her arguments on the liability of foreignness on the principle that foreign firms lack knowledge of the *modus operandi* in the host-country, lack of legitimacy, host country restrictions and an array of additional costs associated to operating at a distance. I argue that, to at least some extent, the lack of familiarity can be overcome by knowledge advantages held, being able to access resources that purely domestic firms cannot access. The lack of legitimacy often attributed to foreign entrants does not seem to be hazardous in Latin America since most foreign firms are from developed countries and considered to have better products and technologies (Oetzel & Doh, 2009). Moreover, albeit Zaheer (1995) pointed that foreign firms suffer from host country restrictions, a number of gradual changes have loosened market protectionism in Latin America (Bruton et al., 2009; Cuervo-Cazurra & Dau, 2009) with governments further implementing tax incentives for foreign investments to attract FDI (Head & Ries, 1996) and more transparent regulations. Finally, the costs associated to geographic distance have been falling and the communication and information technologies have made it simpler and cheaper to manage real time virtually anywhere.

Other scholars have pointed that, in some instances, foreignness can be an asset rather than a liability (e.g., Oetzel & Doh, 2009; Nachum, 2010). The results partially corroborate this idea and further invite researchers to observe how the context may matter. In Latin American countries, for instance, foreign firms seem able to leverage their knowledge advantages to achieve better performance and perform better than the domestic firms. However, the domestic firms can deploy strategies to mitigate the disadvantages and even outcompete foreign firms. For example, gaining greater size and being affiliated to a business groups. These strategies entail overcoming the institutional inefficiencies in two main manners: either by internalizing, thus leading firms to expand into unrelated businesses, or by pooling together the resources needed from partners in a business group. Both strategies are responses to overcome the local institutional inefficiencies in such dimensions as infrastructure, unavailability of efficient suppliers, and ineffectiveness in the distribution channels, politics (where ties to government officials are of paramount importance, as per Liu et al. (2013) and Pinto et al. (in press)), legal and regulatory, and so forth. Hence, it is possible that the results may be pointing to the types of institutional voids and inefficiencies that matter to succeed in these countries. That is, the types of local inefficiencies that may render the foreign or the local firms an advantage. In essence, this means introducing in the liability of foreignness the need to observe the specific institutional setting.

The results failed to attest a significant advantage of foreign-local partnership firms over domestic peers. This is possibly related to the objective of having mixed-ownership structures. As firms use these kinds of structures to learn from local partners, it is possible that firms have a little less focus on performance while learning.

Business groups may bring in the political connections required under conditions of poor institutional contexts. A core feature in Latin American countries is the pervasive interference of governments (Cuervo-Cazurra & Dau, 2009) both formally as a client and supplier, and through corruption of public officials (Cuervo-Cazurra & Genc, 2008). Local firms are perceived as dependents of overprotection from government funds (Kostova & Zaheer, 1999). Domestic firms are more likely to hold political connections but they will likely further access richer political ties through business groups. Foreign MNCs, on the contrary, need to build those ties or seek to establish foreign-local partnerships. In Brazil, for instance, the governments of President Lula and President Dilma have followed a policy of creating ”national champions”, which has essentially driven to the financing of the expansion of a selected few large groups (Pinto et al., in press). These groups have grown to become large multinational players in their industries such as Vale, Cemex, AmBev and JBS, even large multinational players.

4.4.1 Limitations and future research

This study has limitations. First, limitations pertaining to the data. Since the World Bank’s Enterprise Surveys (WBES) does not cover firm-specific resources and capabilities, it is not possible to measure and test which ownership advantages could be central to the advantages of foreignness or de disadvantages of domestic firms. Hence, I were able to test that foreignness can have a positive impact in performance, but could not determine which factors could enable that advantage. Future research can use (and build) a database observing these firm-specific traits to determine which firm-specific resources or capabilities enable advantages of foreignness.

A second limitation pertains to the availability of performance data. The only performance indicator in the database was sales, which I deflated using the value of firms’ assets. This measurement is interesting given the focus on local performance and given that it captures how well firms do in the local country. Nonetheless, using alternative measures of performance would provide additional robustness to the tests, such as EBITDA, ROA, or

other. Finally, using longitudinal data could bring interesting insights into how firms perform and how foreign firms may have performance gains as they accumulate host country experience.

Other limitation that is due to data constrictions is that the WBES does not report the home country of foreign firms. The absence of information about the home country of the firms (or the shareholders of the firms) makes it impossible to analyze differences between foreign firms from developed or emerging countries, as well as effects of institutional differences, or distances. This may be a possible avenue for future inquiry, to observe performance differences across multiple countries of origin of the foreign firms.

4.4.2 Concluding remarks

Revisiting the liabilities of foreignness is needed to include a better understanding of when can foreignness be an advantage, and the foundations over which domestic firms may have an advantage. While it is reasonable to propose that foreign firms are likely to face a number of difficulties and hazards that the domestically bread firms do not have, that assumption may underestimate the ability of foreign firms to face institutionally ineffective environments, learn how to operate in another country and leverage their competitive advantages. Actually, the results point to foreign firms performing better generally and only large domestic firms and domestic firms affiliated to business groups are able to compete. In essence, these are domestic firms that either build internally or access external resources and knowledge which may make them just as competitive or more competitive than foreign firms.

Foreignness and performance are central concepts to international business studies. As companies around the world face challenges in internationalizing to Latin America, and other emerging economies, it is rather necessary to comprehend better how can firms leverage their resources and capabilities in this region. In this study, I have tackled a long-standing debate on the liabilities of foreignness. I examined to what extent the foreignness could be a liability in Latin American countries and arrived at results indicating that domestic firms face liabilities if they are not large or affiliated to a business group. Hymer's (1960) seminal assumptions were largely based on observations in developed countries (Nachum, 2010), but as Latin America presents different institutional settings, foreignness can have different impacts for firms operating in the region. The results of this chapter will hopefully sparkle new research efforts regarding the possible advantages of foreignness in other institutional

contexts and perhaps extending to actually delve into which resources and capabilities held by foreign firms may alleviate the local institutional hazards.

5 CHAPTER 5 - DISCUSSION AND CONCLUSIONS

In this thesis, I investigated how firms react strategically to the institutionally inefficient environments of Latin American countries. Firms have to deal with institutionally inefficient environments and adapt to them (Kostova & Roth, 2002) in order to operate properly and obtain legitimacy (Meyer et al., 2014). In this thesis, I analyzed how firms react and put up strategies to be able to cope and adapt to the inefficient institutional environments they find, specifically, I used the environments of Latin America as a context for these analyses.

The results of the three chapters indicate some insights about the strategic responses of firms. Chapter 2 shown that the institutional inefficiencies can be divided in two dimensions, one pervasive and one arbitrary, and that firms deal with pervasive institutional inefficiencies by choosing to enter with less equity and deal with arbitrary inefficiencies by entering with more equity. Chapter 3 shown that the institutional environment is different between regions of the same country and that firms will take agglomeration of firms and isomorphic pressures into account when choosing the amount of equity in entry mode. The fourth chapter shown that in institutionally inefficient countries, foreign firms are able to perform better than domestic firms, partially contradicting the liability of foreignness rationale, with exception to domestic firms that are associated with business groups.

The conjoint result of these studies is valuable to the discussions of institutional theory in International Business. First, inefficient institutional environments are complex. Although it is possible to obtain interesting results using generalized indicators of national institutional quality (Delios & Beamish, 1999; Meyer, 2001; Dikova & Witteloostuijn, 2007), the results are richer when the anatomy of the institutional environment is dissected. The use of a bi-dimensional matrix of institutional inefficiencies and the focus on regional institutions can be important tools in order to analyze complex strategic responses made by firms.

Second, the results of this thesis shown that the institutional environment does have a series of significant impacts on strategic responses. The adaptation costs that foreign firms have to face do not make them perform worse than domestic firms. Firms would find it more difficult to adapt and achieve legitimacy in institutionally inefficient environments (Wright et al., 2005), hence would also be able to perform better in more developed institutional environments (Peng & Luo, 2000). The rationale of liability of foreignness (Zaheer, 1995) would assume that these adaptation costs would be higher for foreign firms, making them

perform worse than the domestic firms. However, my results show that foreign firms can successfully adapt to the inefficient institutional environment without performing worse than the majority of domestic peers. These results indicate that the strategic responses of foreign firms entering institutionally inefficient countries can successfully help firms cope with adaptation costs.

Third, the results of this thesis raises some further questions about the institutional environment. How can pervasive institutional inefficiencies have different effects on entry mode strategy when considering country-level effects and regional variations? It could be possible that firms fail to evaluate regional characteristics, contradicting Beugelsdijk and Mudambi (2013). Firms already have to deal with complex variables when considering national institutional environments (North, 1990). It could be possible that, as the third chapter shows, regional effects will be more driven by variables that are more visible to firms, as economic centrality of a region and the agglomeration of firms there. The costs of analyzing the whole of regional institutions may be too high, when summed with national evaluations, hence making it possible that firms would only consider national characteristics, then easily evaluable regional characteristics.

This thesis has three main contributions. First, I developed a bi-dimensional matrix, expanding the model of Rodriguez et al. (2005) from corruption to the other institutional inefficiencies. I also shown how these dimensions of pervasive and arbitrary institutional inefficiencies have different effects in firm strategic responses for the entry mode. Hence, the contribution is a new form of evaluating the institutional inefficiencies of a country. By using the bi-dimensional matrix, scholars can delve deeper into the characteristics of institutional inefficiencies and find new evidences for strategic behavior of firms.

The second contribution has a complementary nature. The existence of a bi-dimensional concept to analyze institutional inefficiencies developed a further question about the institutional environment. If institutional inefficiencies are more complex than the previously thought, could the generalization of institutional characteristics by country be a good way of analyzing strategic responses to institutional inefficiencies? In chapter 3 I contribute to IB literature and institutional theory by proposing and empirically showing that institutions vary between regions from the same country, hence, firms' strategic responses will also vary based on these institutional variations. Hence, scholars can use the developed propositions in order to analyze regional effects on strategic responses, as independent and control variables for future studies.

The third contribution arises from the fourth chapter. I propose that, in institutionally inefficient countries, liabilities of foreignness may not be as clear as seminal literature (Hymer, 1960; Zaheer, 1995) propose. I contribute to literature by demonstrating that foreign firms can outperform local competitors with their advantages that allow them to adapt better to the institutionally inefficient environment. On the other hand, I contribute by showing that the liability of foreignness rationale is valid when comparing foreign firms with domestic firms that are associated with business groups, since business group association can help local firms deal with the institutional inefficiencies.

As a conjoint contribution, I highlight the answer for the original research question that drove the thesis “How inefficient institutional environments influence international strategic responses of foreign firms”. Foreign firms’ strategic responses to institutionally inefficient environments are reflected in their use of control to adequate themselves to the institutional environment of the target country, adjusting ownership strategies according to the type of predominant institutional inefficiency and regional characteristics, these strategies help firms to adapt and even outperform their domestic peers.

Additionally, this thesis has demonstrated that the institutionally inefficient environments may not be as negative for foreign firms as previously thought. Although inefficient environments raise adaptation costs, foreign firms that are able to implement correct strategic responses can adapt to the institutional environment and perform well. These indications corroborate to answer questions related to the fact that, if the institutional environment is an important threat to foreign firms, these firms would not be operating in institutionally inefficient countries. Hence, studying the institutional inefficiencies it is possible to draw conclusions that the costs of adapting to an institutionally inefficient country are often compensated by the advantages of accessing local market and resources.

5.1 FUTURE RESEARCH

This thesis has opened the possibilities for a number of future studies. First, it has shown the importance of scrutinizing the characteristics of institutional inefficiencies. Future research can further explore characteristics of institutional inefficiencies, analyzing other logics than pervasive and arbitrary inefficiencies or regional characteristics. As the institutional inefficiencies are a complex matter, there can be a list of other dimensions and variations that arise from diverse factors, that can be further explored by future research.

Second, the possibility of further explore the antecedents of aspects of institutional inefficiencies explored in this thesis. Pervasive and arbitrary inefficiencies are high or low in a country for a number of antecedents, which can be traced to culture, political structure, history, economic situation amongst a list of other reasons. Future research could explore how the macroeconomic and historic backgrounds of a country influence it towards a more pervasive or arbitrary inefficiencies. The same study of antecedents can be used to trace what causes countries to have larger or smaller variations of institutions between its' regions or under which macroeconomic conditions the foreign firms will outperform their domestic peers or the contrary. These answers could contribute to a deeper understanding of the microfoundations of institutional inefficiencies.

Third, future research can also point to the other side of the analysis that were performed in the thesis. I evaluated the strategic responses of firms from the outside, using secondary data. Future research could aim to obtain answers from inside the firms, analyzing cases and responses from executives about the strategic decisions performed in order to adapt to institutionally inefficient environments.

Additionally, future research analysis could aim at contexts other than Latin America. The studies in this thesis comprehend only foreign firms dealing with the Latin American environment. Although the focus of these studies was mostly theoretical, additional evidences could be found by exploring other contexts that are substantially different from Latin America, for instance, Asia, Eastern European and African contexts, since institutional inefficiencies will be different in these contexts.

5.2 CONCLUDING REMARKS

The institutional inefficiencies that surround a country are complex and have multiple layers that can be investigated in order to analyze strategic responses of foreign firms. However, firms that are able to put up successful strategic responses can capitalize in these environments, performing even better than their domestic competitors. The institutional environment of Latin America is still developing towards a more efficient system, nevertheless, firms that are motivated to face these inefficiencies using the right strategies will find opportunities and will ultimately assist in developing the institutional environment.

6 REFERENCES

Agarwal, S., & Ramaswami, S. N. (1992). Choice of foreign market entry mode: Impact of ownership, location and internalization factors. *Journal of International Business Studies*, 23(1), 1-27.

Alesina, A., Özler, S., Roubini, N., & Swagel, P. (1996). Political instability and economic growth. *Journal of Economic Growth*, 1(2), 189-211.

Amaral, G., Olenike, J., & Amaral, L. (2013). *Quantidade De Normas Editadas No Brasil: 25 Anos Da Constituição Federal De 1988*. Retrieved January 13, 2017, from http://www.ibpt.com.br/img/uploads/novelty/estudo/1266/NormasEditadasNos25AnosDaCF.pdf

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

Andersson, M., & Henrekson, M. (2014). Local competitiveness fostered through local institutions for entrepreneurship. In D. Audretsch, A. Link, M., & Walshok (Eds) *Oxford Handbook of Local Competitiveness*. Oxford, UK: Oxford University Press.

Andersson, M., & Larsson, J. (2016). Local entrepreneurship clusters in cities. *Journal of Economic Geography*, 16(1), 39-66.

Ashford, B., & Gibbs, B. (1990). The double-edge of organizational legitimation. *Organization Science*, 1(2), 177-194.

Barkema, H., & Vermeulen, F. (1998). International expansion through start-up or acquisition: A learning perspective. *Academy of Management Journal*, 41(1), 7-26.

Bell, R., Filatotchev, I., & Rasheed, A. (2012). The liability of foreignness in capital markets: Sources and remedies. *Journal of International Business Studies*, 43(2), 107-122.

Berry, H., Guillén, M., & Zhou, N. (2010). An institutional approach to cross-national distance. *Journal of International Business Studies*, 41(9), 1460-1480.

Beugelsdijk, S., & Mudambi, R. (2013). MNEs as border-crossing multi-location enterprises: The role of discontinuities in geographic space. *Journal of International Business Studies*, 44(5), 413-426.

Bevan, A., Estrin, S., & Meyer, K. (2004). Foreign investment location and institutional development in transition economies. *International Business Review*, 13(1), 43-64.

Bernolak, I. (1997). Effective measurement and successful elements of company productivity: The basis of competitiveness and world prosperity. *International Journal of Production*

Economics, 52(1), 203-213.

Bitektine, A., & Haack, P. (2015). The "macro" and the "micro" of legitimacy: Toward a multilevel theory of the legitimacy process. *Academy of Management Review*, 40(1), 49-75.

Björkman, I., Smale, A., Sumelius, J., Suutari, V., & Lu, Y. (2008). Changes in institutional context and MNC operations in China: Subsidiary HRM practices in 1996 versus 2006. *International Business Review*, 17(2), 146-158.

Boeh, K., & Beamish, P. (2012). Travel time and the liability of distance in foreign direct investment: Location choice and entry mode. *Journal of International Business Studies*, *43*(5), 525-535.

Brannen, M., Piekkari, R., & Tietze, S. (2014). The multifaceted role of language in international business: Unpacking the forms, functions and features of a critical challenge to MNC theory and performance. *Journal of International Business Studies*, 45(5), 495-507.

Brewer, T. L. (1993). Government policies, market imperfections, and foreign direct investment. *Journal of International Business Studies*, 24(1), 101-120.

Brockman, P., Rui, O., & Zou, H. (2013). Institutions and the performance of politically connected M&As. *Journal of International Business Studies*, 44(8), 833-852.

Brouthers, K. (2013). Institutional, cultural and transaction cost influences on entry mode choice and performance. *Journal of International Business Studies*, 44(1), 1-13.

Brouthers, K., & Brouthers, L. (2003). Why service and manufacturing entry mode choices differ: The influence of transaction cost factors, risk and trust. *Journal of Management Studies*, 40(5), 1179-1204.

Bruton, G., Ahlstrom, D., & Puky, T. (2009). Institutional differences and the development of entrepreneurial ventures: A comparison of the venture capital industries in Latin America and Asia. *Journal of International Business Studies*, 40(5), 762-778.

Buckley, P., Clegg, J., Wang, C. (2002). The impact of inward FDI on the Performance of Chinese Manufacturing Firms, *Journal of International Business Studies*, 33(4), 637-655.

Calhoun, M. (2002). Unpacking liability of foreignness: identifying culturally driven external and internal sources of liability for the foreign subsidiary. *Journal of International Management*, *8*(3), 301-321.

Calof, J. (1994). The relationship between firm size and export behavior revisited. *Journal of International Business Studies*, *25*(2), 367-387.

Castellacci, F. (2015). Institutional voids or organizational resilience? Business groups, innovation, and market development in Latin America. *World Development*, *70*, 43-58.

Celo, S., & Chacar, A. (2015). International coherence and MNE performance. *Journal of International Business Studies*, 46(1), 620-628.

Chan, C., & Makino, S. (2007). Legitimacy and multi-level institutional environments: Implications for foreign subsidiary ownership structure. *Journal of International Business Studies*, 38(4), 621-638.

Chang, S., & Choi, U. (1988). Strategy, structure and performance of Korean business groups: A transactions cost approach. *The Journal of Industrial Economics*, 37(2), 141-158.

Chari, M. (2013). Business groups and foreign direct investments by developing country firms: An empirical test in India. *Journal of World Business*, 48(3), 349-359.

Chari, M., & Chang, K. (2009). Determinants of the share of equity sought in cross-border acquisitions. *Journal of International Business Studies*, 40(8), 1277–1297

Chen, S. (2008). The motives for international acquisitions: Capability procurements, strategic considerations, and the role of ownership structures. *Journal of International Business Studies*, 39(3), 454-471.

Chen, S., & Hennart, J. (2004). A hostage theory of joint ventures: Why do Japanese investors choose partial over full acquisitions to enter the United States?. *Journal of Business Research*, 57(10), 1126-1134.

Collins, J. (1990). A market performance comparison of US firms active in domestic, developed and developing countries. *Journal of International Business Studies*, 21(2), 271-287.

Combes, P., Duranton, G., & Gobillon, L. (2011). The identification of agglomeration economies. *Journal of Economic Geography*, 11(2), 253-266.

Contractor, F. J., Kundu, S. K., & Hsu, C. C. (2003). A three-stage theory of international expansion: The link between multinationality and performance in the service sector. *Journal of International Business Studies*, 34(1), 5-18.

Contractor, F., Lahiri, S., Elango, B., & Kundu, S. (2014). Institutional, cultural and industry related determinants of ownership choices in emerging market FDI acquisitions. *International Business Review*, 23(5), 931-941.

Cuervo-Cazurra, A. (2008). Better the devil you don't know: Types of corruption and FDI in transition economies. *Journal of International Management*, 14(1), 12-27.

Cuervo-Cazurra, A., & Dau, L. (2009). Pro-market reforms and firm profitability in developing countries. *Academy of Management Journal*, 52(6), 1348-1368.

Cuervo-Cazurra, A., & Genc, M. (2008). Transforming disadvantages into advantages: Developing-country MNEs in the least developed countries. *Journal of International Business Studies*, 39(6), 957-979.

Cuervo-Cazurra, A., Maloney, M., & Manrakhan, S. (2007). Causes of the difficulties in internationalization. *Journal of International Business Studies, 38*(5), 709-725.

Dacin, M., Oliver, C., & Roy, J. P. (2007). The legitimacy of strategic alliances: An institutional perspective. *Strategic Management Journal*, 28(2), 169-187.

Daniel, S., Cieslewicz, A., & Pourjalali, H. (2012). The impact of national economic culture and country-level institutional environment on corporate governance practices. *Management International Review*, 52(3), 365-394.

Deephouse, D. (1996). Does isomorphism legitimate? *Academy of Management Journal*, 39(4), 1024-1039.

Demirbag, M., McGuinness, M., & Altay, A. (2010). Perceptions of institutional environment and entry mode. *Management International Review*, 50(2), 207-240.

Delios, A., & Beamish, P. (1999). Ownership strategy of Japanese firms: Transactional, institutional, and experience influences. *Strategic Management Journal*, 20(10), 915-933.

DiMaggio, P., & Powell, W. (1983). The iron cage revisited: Institutional isomorphism and collective rationality in organizational fields. *American Sociological Review*, 48(2), 147-160.

Dikova, D., & Van Witteloostuijn, A. (2007). Foreign direct investment mode choice: entry and establishment modes in transition economies. *Journal of International Business Studies, 38*(6), 1013-1033.

Doh, J., Rodriguez, P., Uhlenbruck, K., Collins, J., & Eden, L. (2003). Coping with corruption in foreign markets. *Academy of Management Executive*, 17(3), 114-127.

Dow, D., Cuypers, I., & Ertug, G. (2016). The effects of within-country linguistic and religious diversity on foreign acquisitions. *Journal of International Business Studies*, 47(3), 319-346.

Dunning, J. (2006). Towards a new paradigm of development: Implications for the determinants of international business. *Transnational Corporations*, 15(1), 173-227.

Dunning, J. (1998). Location and the multinational enterprise: a neglected factor?. *Journal of International Business Studies*, 29(1), 45-66.

Early, D., & Winton, P. (2001). Preparing the workforce: Early childhood teacher preparation at 2-and 4-year institutions of higher education. *Early Childhood Research Quarterly*, 16(3),

285-306.

Eden, L., & Miller, S., (2004). Distance matters: Liability of foreignness, institutional distance and ownership strategy. *Advances in International Management*, 16: 187-221.

Edmiston, K., Mudd, S., & Valev, N. (2003). Tax structures and FDI: The deterrent effects of complexity and uncertainty. *Fiscal Studies*, 24(3), 341-359.

Etzkowitz, H., & Leydesdorff, L. (2000). The dynamics of innovation: From National Systems and "Mode 2" to a Triple Helix of university–industry–government relations. *Research Policy*, 29(2), 109-123.

Evans, D. (1987). Tests of alternative theories of firm growth. *journal of political economy*, *95*(4), 657-674.

Evans, J., & Mavondo, F. (2002). Psychic distance and organizational performance: An empirical examination of international retailing operations. *Journal of International Business Studies*, 33(3), 515-532.

Ferreira, M. (2008). Building and leveraging knowledge capabilities through cross-border acquisitions. In Tallman, S. (Ed.), *New Generation in International Strategy*. New York, NY: Edward Elgar Publishing

Ferreira, M., Li, D., Guisinger, S., & Serra, F. (2009). Is the International Business Environment the actual context for international business research?. *Revista de Administração de Empresas*, 49(3), 282-294.

Ferreira, M., & Serra, F. (2015). Abordagem Conceitual às Estratégias de Internacionalização sob Pressões Institucionais Duais para Legitimidade e Conformidade. *Revista de Administração Contemporânea*, 19(4), 440.

Ferreira, M., Carreira, H., Li, D., & Serra, F. (2016). The moderating effect of home country corruption on the host country's ability to attract FDI. *Brazilian Business Review*, 13(4), 94-130.

Ferreira, M., Vicente, S., Borini, F., & Almeida, M. (2017). Degree of equity ownership in cross-border acquisitions of Brazilian firms by multinationals: a strategic response to institutional distance. *Revista de Administração*. 52(1), 59-69.

Folta, T., Cooper, A., & Baik, Y. (2006). Geographic cluster size and firm performance. *Journal of Business Venturing*, 21(2), 217-242.

Fields, K. (1995). *Enterprise and the State in Korea and Taiwan*. Ithaca, NY: Cornell University Press.

Finch, H. (2015). Utopia in Uruguay Redefined. In Abel, C., & Lewis, C. (Eds.). *Welfare*,

poverty and development in Latin America. London, UK: Springer.

Fleury, A., Shi, Y., Junior, S., Cordeiro, J., & Fleury, M. (2015). Developing an analytical framework for study of emerging country multinationals' operations management. *International Journal of Production Research*, 53(18), 5418-5436.

Fuentes, C. (2015). Shifting the Status Quo: Constitutional Reforms in Chile. *Latin American Politics and Society*, 57(1), 99-122.

Gatignon, H., & Anderson, E. (1988). The multinational corporation's degree of control over foreign subsidiaries: An empirical test of a transaction cost explanation. *Journal of Law, Economics & Organization*, 4(2), 305–336.

Gaur, A., Delios, A., & Singh, K. (2007). Institutional environments, staffing strategies, and subsidiary performance. *Journal of Management*, 33(4), 611-636.

Gaffney, N., Karst, R., & Clampit, J. (2016). Emerging market MNE cross-border acquisition equity participation: The role of economic and knowledge distance. *International Business Review*, *25*(1), 267-275.

Ghemawat, P. (2001). Distance still matters. *Harvard Business Review*, 79(8), 137-147.

Glaeser, E., Kolko, J., & Saiz, A. (2001). Consumer city. *Journal of Economic Geography*, 1(1), 27-50.

Goerzen, A., Asmussen, C., & Nielsen, B. (2013). Global cities and multinational enterprise location strategy. *Journal of International Business Studies*, 44(5), 427–450.

Gomes, E., Winter, L., & Rossi, A. (2016). Protestos Na Venezuela E A Busca Do Diálogo. *Direito*, 2(23), 2-7.

Guisinger, S. (2001). From OLI to OLMA: incorporating higher levels of environmental and structural complexity into the eclectic paradigm. *International Journal of the Economics of Business*, 8(2), 257-272.

Hair, J., Black, W., Babin, B., Anderson, R., & Tatham, R. (2009). *Análise multivariada de dados*. Bookman Editora.

Hassett, K. and Hubbard, R. (1997), 'Tax policy and investment', in A. Auerbach (ed.), *Fiscal Policy: Lessons from the Literature*, Cambridge, MA: MIT Press.

Hartman, D. (1985). Tax policy and foreign direct investment. *Journal of Public Economics*, 26(1), 107-121.

Head, K., & Ries, J. (1996). Inter-city competition for foreign investment: Static and dynamic effects of China's incentive areas. *Journal of Urban Economics*, 40(1), 38-60.

Henisz, W. (2000). The institutional environment for economic growth. *Economics & Politics*,

12(1), 1-31.

Henisz, W. (2002). The institutional environment for infrastructure investment. *Industrial and Corporate Change*, 11(2), 355-389.

Henisz, W. (2003). The power of the Buckley and Casson thesis: the ability to manage institutional idiosyncrasies. *Journal of International Business Studies*, 34(2), 173-184.

Hennart, J. (1988). A transaction costs theory of equity joint ventures. *Strategic Management Journal*, 9(4), 361-374.

Hennart, J.-F., Roehl, T., & Zeng, M. (2002). Do exits proxy a liability of foreignness?: The case of Japanese exits from the US. *Journal of International Management*, 8(1), 241–265.

Herrmann-Pillath, C. (2010). Social capital, Chinese style: Individualism, relational collectivism and the cultural embeddedness of the institutions–performance link. *China Economic Journal*, 2(3), 325-350.

Hendricks, K., & Singhal, V. (2008). The effect of product introduction delays on operating performance. *Management Science*, 54(5), 878-892.

Hillman, A., & Wan, W. (2005). The determinants of MNE subsidiaries' political strategies: evidence of institutional duality. *Journal of International Business Studies*, 36(3), 322-340.

Hirsch, P. (1975). Organizational effectiveness and the institutional environment. *Administrative Science Quarterly*, 20(3), 327-344.

Hofstede, G., de Hilal, A. V. G., Malvezzi, S., Tanure, B., & Vinken, H. (2010). Comparing regional cultures within a country: Lessons from Brazil. *Journal of Cross-Cultural Psychology*, 41(3), 336-352.

Hope, O., Thomas, W., & Vyas, D. (2011). Financial credibility, ownership, and financing constraints in private firms. *Journal of International Business Studies*, 42(7), 935-957.

Huselid, M. (1995). The impact of human resource management practices on turnover, productivity, and corporate financial performance. *Academy of Management Journal*, 38(3), 635-672.

Hymer, S. (1960). *The international operations of national firms: a study of direct investment*. PhD Thesis, Michigan Institute of Technology, Cambridge.

Ismail, K., Ford, D., & Ferreira, M. (2008). Organizational responses to institutional upheaval by central Eurasian firms and the ability to transform under uncertainty. *Journal of Asia Business Studies*, 2(2), 1-12.

Jackson, G., & Deeg, R. (2008). Comparing capitalisms: Understanding institutional diversity

and its implications for international business. *Journal of International Business Studies*, 39(4), 540-561.

Jensen, N., Li, Q., & Rahman, A. (2010). Understanding corruption and firm responses in cross-national firm-level surveys. *Journal of International Business Studies*, 41(9), 1481-1504.

Jong, E., & Bogmans, C. (2011). Does corruption discourage international trade?. *European Journal of Political Economy*, 27(2), 385-398.

Kang, Y., & Jiang, F. (2012). FDI location choice of Chinese multinationals in East and Southeast Asia: Traditional economic factors and institutional perspective. *Journal of World Business*, 47(1), 45-53.

Khanna, T., & Palepu, K. (2000a). The future of business groups in emerging markets: Long-run evidence from Chile. *Academy of Management Journal*, 43(3), 268-285.

Khanna, T., & Palepu, K. (2000b). Is group affiliation profitable in emerging markets? An analysis of diversified Indian business groups. *Journal of Finance*, 55(2), 867-891.

Khanna, T., Rivkin, J. (2001). Estimating the performance of business groups in emerging markets. *Strategic Management Journal*, 22(1), 45–74.

Kim, H., & Jensen, M. (2014). Audience heterogeneity and the effectiveness of market signals: How to overcome liabilities of foreignness in film exports?. *Academy of Management Journal*, *57*(5), 1360-1384.

Knack, S., & Keefer, P. (1995). Institutions and economic performance: cross-country tests using alternative institutional measures. *Economics & Politics*, 7(3), 207-227.

Kogut, B., & Zander, U. (1993). Knowledge of the firm and the evolutionary theory of the multinational corporation. *Journal of International Business Studies*, *24*(4), 625-645.

Kostova, T., & Roth, K. (2002). Adoption of an organizational practice by subsidiaries of multinational corporations: Institutional and relational effects. *Academy of Management Journal*, *45*(1), 215-233.

Kostova, T., & Zaheer, S. (1999). Organizational legitimacy under conditions of complexity: The case of the multinational enterprise. *Academy of Management Review*, 24(1), 64-81.

Krugman, P. (1991). Increasing returns and economic geography. *Journal of Political Economy*, 99(3). 483-499.

Lamin, A., & Livanis, G. (2013). Agglomeration, catch-up and the liability of foreignness in emerging economies. *Journal of International Business Studies*, 44(6), 579-606.

Lau, C., Tse, D., & Zhou, N. (2002). Institutional forces and organizational culture in China: Effects on change schemas, firm commitment and job satisfaction. *Journal of*

International Business Studies, 33(3), 533-550.

Lee, S., & Oh, K. (2007). Corruption in Asia: Pervasiveness and arbitrariness. *Asia Pacific Journal of Management*, 24(1), 97-114.

Lee, Y., Hemmert, M., & Kim, J. (2014). What drives the international ownership strategies of Chinese firms? The role of distance and home-country institutional factors in outward acquisitions. *Asian Business & Management*, 13(3), 197–225.

Lepak, D., & Snell, S. (1999). The human resource architecture: Toward a theory of human capital allocation and development. *Academy of Management Review*, *24*(1), 31-48.

Liu, N., Wang, L., & Zhang, M. (2013). Corporate ownership, political connections and M&A: Empirical evidence from China. *Asian Economic Papers*, 12(3), 41-57.

Lu, J. (2002). Intra-and inter-organizational imitative behavior: Institutional influences on Japanese firms' entry mode choice. *Journal of International Business Studies*, 33(1), 19-37.

Lu, J., Liu, X., Wright, M., & Filatotchev, I. (2014). International experience and FDI location choices of Chinese firms: The moderating effects of home country government support and host country institutions. *Journal of International Business Studies*, 45(4), 428-449.

Luo, Y., & Mezias, J. (2002). Liabilities of foreignness: concepts, constructs, and consequences. *Journal of International Management*, 8, 217–221.

Luo, Y., & Tung, R. (2008). International expansion of emerging market enterprises: A springboard perspective. *Journal of International Business Studies*, 38(4), 481-498.

Ma, X., Delios, A., & Lau, C. (2013). Beijing or Shanghai? The strategic location choice of large MNEs' host-country headquarters in China. *Journal of International Business Studies*, 44(9), 953-961.

Makino, S., Lau, C. M., & Yeh, R. S. (2002). Asset-exploitation versus asset-seeking: Implications for location choice of foreign direct investment from newly industrialized economies. *Journal of International Business Studies*, 33(3), 403-421.

Malhotra, S., Lin, X., & Farrell, C. (2016). Cross-national uncertainty and level of control in cross-border acquisitions: A comparison of Latin American and US multinationals. *Journal of Business Research*, 69(6), 1993–2004.

March, J. (1991). Exploration and exploitation in organizational learning. *Organization Science*, 2(1), 71-87.

McCann, P. (1995). Rethinking the economics of location and agglomeration. *Urban Studies*, 32(3), 563-577.

McEvily, B., & Zaheer, A. (1999). Bridging ties: A source of firm heterogeneity in competitive capabilities. *Strategic Management Journal*, 20(12), 1133-1156.

Meyer, J., & Rowan, B. (1977). Institutionalized organizations: Formal structure as myth and ceremony. *American Journal of Sociology*, 83(2), 340-363.

Meyer, K. (2001). Institutions, transaction costs, and entry mode choice in Eastern Europe. *Journal of International Business Studies*, *32*(2), 357-367.

Meyer, K. E., Mudambi, R., & Narula, R. (2011). Multinational enterprises and local contexts: The opportunities and challenges of multiple embeddedness. *Journal of Management Studies*, 48(2), 235-252.

Meyer, K., Ding, Y., Li, J., & Zhang, H. (2014). Overcoming distrust: How state-owned enterprises adapt their foreign entries to institutional pressures abroad. *Journal of International Business Studies*, 45(8), 1005-1028.

Meyer, K., Estrin, S., Bhaumik, S., & Peng, M. (2009). Institutions, resources, and entry strategies in emerging economies. *Strategic Management Journal*, 30(1), 61-80.

Mezias, J. (2002). How to identify liabilities of foreignness and assess their effects on multinational corporations. *Journal of International Management*, 8(3), 265–282.

Mezias, J. (2002). Identifying liabilities of foreignness and strategies to minimize their effects: The case of labor lawsuit judgments in the United States. *Strategic Management Journal*, 23(3), 229-244.

Miles, R. & C. Snow. (1978). *Organizational strategy, structure, and process*. New York: McGraw-Hill.

Miller, D. (1999). The norm of self-interest. *American Psychologist*, 54(12), 1053.

Miller, K. (1992). A framework for integrated risk management in international business. *Journal of International Business Studies*, *23*(2), 311-331.

Mowery, D., Oxley, J., & Silverman, B. (1996). Strategic alliances and interfirm knowledge transfer. *Strategic Management Journal*, 17(2), 77-91.

Mudambi, R., & Zahra, S. (2007). The survival of international new ventures. *Journal of International Business Studies*, 38(2), 333-352.

Nachum, L. (2010). When is foreignness an asset or a liability? Explaining the performance differential between foreign and local firms. *Journal of Management*, 36(3), 714-739.

North, D. (1990). *Institutions, institutional change and economic performance*. Cambridge University Press. Cambridge.

Oetzel, J., & Doh, J. (2009). MNEs and development: A review and reconceptualization.

Journal of World Business, 44(2), 108-120.

Oliver, C. (1991). Strategic responses to institutional processes. *Academy of Management Review*, 16(1), 145-179.

Oxley, J., & Yeung, B. (2001). E-commerce readiness: Institutional environment and international competitiveness. *Journal of International Business Studies*, 32(4), 705-723.

Peng, M. (2002). Towards an institution-based view of business strategy. *Asia Pacific Journal of Management, 19*(2), 251-267.

Peng, M., & Luo, Y. (2000). Managerial ties and firm performance in a transition economy: The nature of a micro-macro link. *Academy of Management Journal*, 43(3), 486-501.

Peng, M., Wang, D., & Jiang, Y. (2008). An institution-based view of international business strategy: A focus on emerging economies. *Journal of International Business Studies*, 39(5), 920-936.

Peng, M., Sun, S., Pinkham, B., & Chen, H. (2009). The Institution-Based View as a third leg for a strategy tripod. *The Academy of Management Perspectives*, 23(3), 63-81.

Petrou, A. (2014). Bank foreign affiliate performance in the face of pervasive and arbitrary corruption. *European Management Review*, 11(3-4), 209-221.

Pfeffer, J., & Salancik, G. (1978). *The External Control of Organizations*. New York, NY: New York Press.

Phene, A., Tallman, S., & Almeida, P. (2012). When do acquisitions facilitate technological exploration and exploitation? *Journal of Management*, 38(3), 753-783.

Pinto, C., Ferreira., Falaster, C., Fleury, M., Fleury, A. (In press). *Ownership in Cross-Border Acquisitions and the Role of Government Support*. Journal of World Business.

Pinto, C., Falaster, C., Canela, R., Fleury, M., Fleury, A. (2015). *The impact of institutional distance, government support and firm's acquisition capability on the equity ownership acquired by emerging multinationals in cross-border acquisitions.* Academy of Management Meeting, 7-11 August 2015, Vancouver, Canada.

Piscitello, L. (2011). Strategy, location, and the conceptual metamorphosis of the MNE. *Global Strategy Journal*, 1(1–2), 127–131.

Pouder, R., & John, C. (1996). Hot spots and blind spots: Geographical clusters of firms and innovation. *Academy of Management Review*, 21(4), 1192-1225.

Regner, P., & Zander, U. (2014). International strategy and knowledge creation: The advantage of foreignness and liability of concentration. *British Journal of Management*, 25(3), 551-569.

Riahi-Belkaoui, A., & Pavlik, E. (1991). Asset management performance and reputation building for large US firms. *British Journal of Management*, 2(4), 231-238.

Rodriguez, P., Uhlenbruck, K., & Eden, L. (2005). Government corruption and the entry strategies of multinationals. *Academy of Management Review*, 30(2), 383-396.

Roth, K., & Kostova, T. (2003). Organizational coping with institutional upheaval in transition economies. *Journal of World Business*, 38(4), 314-330.

Rowan, B. (1982). Organizational structure and the institutional environment: The case of public schools. *Administrative Science Quarterly*, 27(2), 259-279.

Salomon, R., & Wu, Z. (2012). Institutional distance and local isomorphism strategy. *Journal of International Business Studies*, 43(4), 343-367.

Sethi, D., & Guisinger, S. (2002). Liability of foreignness to competitive advantage: how multinational enterprises cope with the international business environment. *Journal of International Management*, 8(3), 223–240.

Simon, H. (1955). A behavioral model of rational choice. *The Quarterly Journal of Economics*, 69(1), 99-118.

Sigler, T. (2014). Panama as palimpsest: The reformulation of the 'transit corridor' in a global economy. *International Journal of Urban and Regional Research*, 38(3), 886-902.

Singh, M., Nejadmalayeri, A., & Mathur, I. (2007). Performance impact of business group affiliation: An analysis of the diversification-performance link in a developing economy. *Journal of Business Research, 60*(4), 339-347.

Stal, E., & Cuervo-Cazurra, A. (2011). The investment development path and FDI from developing countries: The role of pro-market reforms and institutional voids. *Latin American Business Review*, 12(3), 209-231.

Stopford, J. & Wells, L. (1972). *Managing the multinational enterprise*. New York: Basic Books.

Suchman, M. (1995). Managing legitimacy: Strategic and institutional approaches. *Academy of Management Review*, 20(3), 571-610.

Tallman, S. & Li, J. (1996). Effects of international diversity and product diversity on the performance of multinational firms. *Academy of Management Journal*, 39(1), 179-196.

Tallman, S., & Fladmoe-Lindquist, K. (2002). Internationalization, globalization, and capability-based strategy. *California Management Review*, 45(1), 116-135.

Tang, J., & Rowe, W. (2012). The liability of closeness: Business relatedness and foreign subsidiary performance. *Journal of World Business*, 47(2), 288-296.

Thomson Reuters. (2016). *Mergers and Acquisitions Database*. Retrieved from: http://financial.thomsonreuters.com/en/markets-industries/investment-banking-financial-advisory/mergers-and-acquisitions.html in 10/05/2016.

Uhlenbruck, K., Rodriguez, P., Doh, J., & Eden, L. (2006). The impact of corruption on entry strategy: Evidence from telecommunication projects in emerging economies. *Organization Science*, 17(3), 402-414.

Voss, H., Buckley, P., & Cross, A. (2009). An assessment of the effects of institutional change on Chinese outward direct investment activity. In Alon, I., Fetcherin, M., Gulger, P. (Eds.), *China rules: Globalization and political transformation*. London, UK: Palgrave Macmillan, 135-165.

Warskett, G., Winer, S., & Hettich, W. (1998). The complexity of tax structure in competitive political systems. *International Tax and Public Finance*, *5*(2), 123-151.

Williamson, O. (1981). The economics of organization: The transaction cost approach. *American Journal of Sociology*, 87(3), 548-577.

Winters, J. (2013). Human capital externalities and employment differences across metropolitan areas of the USA. *Journal of Economic Geography*, 13(5), 799-822.

Wong, C. Y., & Boon-Itt, S. (2008). The influence of institutional norms and environmental uncertainty on supply chain integration in the Thai automotive industry. *International Journal of Production Economics*, 115(2), 400-410.

World Bank. (2016). *Enterprise Surveys*. Retrieved from http://www.enterprisesurveys.org/data in 20/5/2016.

World Bank Data. (2016). *World Bank Open Data*. Retrieved from http://data.worldbank.org/ in 20/5/2016.

Woodcock, C., Beamish, P., & Makino, S. (1994). Ownership-based entry mode strategies and international performance. *Journal of International Business Studies*, *25*(2), 253-273.

Wright, M., Filatotchev, I., Hoskisson, R. E., & Peng, M. W. (2005). Strategy research in emerging economies: Challenging the conventional wisdom. *Journal of Management Studies*, 42(1), 1-33.

Wu, F., Yeniyurt, S., Kim, D., & Cavusgil, S. (2006). The impact of information technology on supply chain capabilities and firm performance: A Resource-Based view. *Industrial Marketing Management*, 35(4), 493-504.

Xia, J., Tan, J. & Tan, D. (2008) Mimetic Entry And Bandwagon Effect: The Rise And Decline Of International Equity Joint Venture In China. *Strategic Management Journal*, 29(1),

195-217.

Zaheer, S. (1995). Overcoming the liability of foreignness. *Academy of Management Journal*, 38(2), 341-363.

Zaheer, S. (2002). The liability of foreignness, redux: A commentary. *Journal of International Management*, 8, 351–358.

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), 439-463.

Zenger, T., Lazzarini, S., & Poppo, L. (2000). *Informal and formal organization in new institutional economics*. In: Ingram, P. and Silverman, B. (Eds.) The New Institutionalism in Strategic Management (Advances in Strategic Management, Volume 19) Emerald Group Publishing, 277 – 305.