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**The Dominant Practice for Foreign  
Subsidiary Staffing and the Subsidiary  
Performance**

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# **THE DOMINANT PRACTICE FOR FOREIGN SUBSIDIARY STAFFING AND THE SUBSIDIARY PERFORMANCE**

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## **ABSTRACT**

This study examines whether isomorphic behavior by multinational corporations positively or negatively affect the performance of foreign subsidiaries. Although previous studies find that multinational corporations have a tendency to mimic practices adopted by other firms, the financial consequences of mimetic behavior remains uncovered. This study addresses multinational corporations' isomorphic behavior regarding foreign subsidiary staffing and hypothesizes the relationship between the imitation of the dominant practice for subsidiary staffing and the subsidiary performance. The panel dataset consisting of 3,284 foreign subsidiaries of multinational corporations are used to test the hypotheses. The results obtained from a fixed effect model indicate that the imitation of the dominant practice adopted in the host country negatively affects the subsidiary performance. This study also finds that the negative relationship between mimetic behavior and subsidiary performance becomes greater as the institutional distance between the host country and the home country increases. The results of this study suggest that isomorphic behavior in pursuit of legitimacy is accompanied by the loss of efficiency.

**Key words:** isomorphism; legitimacy; foreign subsidiary staffing; subsidiary performance; institutional distance.

## INTRODUCTION

Institutional theory has been employed to understand how sociological factors constrain behavior of individuals and organizations (DiMaggio and Powell, 1983; North, 1990; Scott, 2008). Institutional theorists are interested in explaining the convergence and the resultant uniformity of organizational structures and practices (Roberts and Greenwood, 1997). A primary contention of institutional theory is that organizations are subject to a set of sociological pressures (DiMaggio and Powell, 1983; Scott, 2008). Sociological pressures force organizations to adopt structures and practices that are perceived to be appropriate within the social context where they are embedded (DiMaggio and Powell, 1983; Scott, 2008). By adopting appropriate structures and practices, organizations can acquire legitimacy in the society (Björkman, Fey, and Park, 2007; DiMaggio and Powell, 1983; Scott, 2008). Because social acceptance and legitimacy increases the probability of their survival, organizations sharing the same social context employ similar structures and practices (DiMaggio and Powell, 1983; Martinez and Dacin, 1999.). As a result, organizations in the same society become isomorphic with one another (Barreto and Baden-Fuller, 2006; DiMaggio and Powell, 1983).

Applying institutional theory to analysis of multinational corporations (MNCs) entering foreign markets, previous studies on international business explored MNCs' isomorphic behavior. For example, Salomon and Wu (2012) showed that foreign banks mimic the asset strategy of local competitors. Yiu and Makino (2002) also showed that manufacturers engaged in home-electronics and automobile industries imitate entry mode choice adopted by counterparts from the same home country. These studies showed under which conditions MNCs imitate practices and decisions of other firms. However, few studies examined the

consequences of isomorphic behavior (Barreto and Baden-Fuller, 2006; Westphal, Gulati, and Shortell, 1997). It is still uncovered whether imitation of behavior and practices of other firms enhances or deteriorates the performance of MNCs. Mimicking practices that are adopted by other organizations within the social context helps the focal organization gain legitimacy in the society (Deepphouse, 1996, 2005). Although this behavior is considered normatively rational (Oliver, 1997), normatively rational behavior is not always equivalent to economically rational behavior. We still do not have adequate knowledge about the effect of isomorphic behavior by MNCs on their performance in host countries. We need to explore whether normatively rational behavior is economically rational and in which situations isomorphic behavior positively or negatively affects the performance of MNCs. To explore these questions, this study proposes that legitimacy seeking through isomorphic behavior is accompanied by the cost to gain legitimacy. This study focuses on MNCs' isomorphic behavior regarding a staffing practice for foreign subsidiaries and examines how adoption of the staffing practice prevailing in the host country affects the performance of foreign subsidiaries. Among staffing practices for foreign subsidiaries, this study investigates the ratio of parent country nationals (PCN) to subsidiary employees (the PCN ratio) because it is the most studied practice in previous studies (Gaur, Delios, and Singh, 2007; Gong, 2003; Tan and Mahoney, 2006).

This study organized as follows. The next section reviews the literature on institutional theory and isomorphic behavior as well as studies that analyzed isomorphic behavior by MNCs. Then, the hypotheses explaining the relationship between isomorphic behavior regarding foreign subsidiary staffing and subsidiary performance are developed. The hypotheses are tested using a panel dataset consisting of 3,284 foreign subsidiaries of MNCs.

After reporting the results of the empirical analysis, the implications, as well as limitations and directions for future research, are discussed.

## **LITERATURE REVIEW**

Institutional theory assumes that firms' behavior is constrained by a set of institutional pressures from the society as they are embedded in the social context (DiMaggio and Powell, 1983; Scott, 1995). Institutional pressures force firms to adopt organizational practices and structures that are perceived to be appropriate within the social context (DiMaggio and Powell, 1983; Salomon and Wu, 2012; Scott, 2008). Institutions are defined as the rules of the game in a society, or the humanly devised constraints that shape human interaction (North 1990). Institutions provide guidelines and resources for taking action as well as prohibitions and constraints on action (Scott, 2008). Organizational practices that conform to requirements from institutions are perceived to be socially appropriate and accepted. By taking socially appropriate action, firms can gain legitimacy within the institutional context (Scott, 2008). Firms seek to gain legitimacy by adopting socially appropriate practices and increase the probability of their survival (Björkman et al., 2007; DiMaggio and Powell, 1983; Scott, 2008). Legitimacy-seeking behavior by firms in the society results in the adoption of similar practices and the imitation of other firms' practices (DiMaggio and Powell, 1983). A tendency to take mimetic behavior strengthens when firms operate in uncertain and ambiguous environments (Deephouse, 1996; DiMaggio and Powell, 1983; Salomon and Wu, 2012). In uncertainty, firms have difficulty taking economically rational action (Haunschild and Miner, 1997). Instead, firms mimic dominant practices and strategies, which provides them with legitimacy and increases the likelihood of survival in uncertain environments (Chan, Makino

and Isobe, 2006; DiMaggio and Powell, 1983; Scott, 1995; Yiu and Makino, 2002).

Based on these arguments, previous studies examined how MNCs imitate other firms' practices and adopt socially appropriate practices when they enter and operate in host countries. Guillén (2002) conducted a longitudinal analysis of South Korean firms entering into China and found that behavior of firms belonging to the same business group and firms belonging to the same industry influences a firm's decisions on entry into China. Using a data of Japanese firms, Henisz and Delios (2001) found that when Japanese firms make a decision on international plant location, they imitate the past decision by other Japanese firms. They also found that Japanese firms with less host country experience tend to imitate the past international expansion decisions of other Japanese firms (Henisz and Delios, 2001). Several studies examined isomorphic behavior of MNCs regarding entry mode choice. For example, Chan and Makino (2007) used a dataset of Japanese firms and found that Japanese firms imitate other Japanese firms when they decide the level of the ownership stake in the foreign subsidiary. They also found that this tendency strengthens as political instability of the host country increases (Chan and Makino, 2007). By using a dataset of foreign direct investment in China, Xia, Tan, and Tan (2008) showed that selection by foreign entrants of equity joint venture is affected by industry peers from the same home country and the same host country. Salomon and Wu (2012) used a dataset of foreign banks in the U.S. and found that foreign banks are more likely to imitate local banks' asset strategy as institutional distance between the host country and the home country increases.

These studies showed that MNCs imitate other firms' action in managing subsidiaries overseas. Although mimicking socially appropriate and prevailing practices enhances the firm's legitimacy within the institutional context, mimetic behavior does not necessarily mean

an economically rational decision (Barreto and Baden-Fuller, 2006; Oliver, 1997; Xu, Pan, and Beamish, 2004.). Mimicking dominant practices enhances legitimacy of the firm and increases the likelihood of its survival in uncertain situations (Chan et al., 2006; DiMaggio and Powell, 1983; Scott, 1995; Yiu and Makino, 2002). In certain environments, however, firms do not have clear and complete information that a given practice is the best way to increase their efficiency (Deepphouse, 1996; Zimmerman and Zeitz, 2002). Because imitation of practices adopted by other firms at least enhances legitimacy and mitigates the liabilities of foreignness (Zimmerman and Zeitz, 2002), the imitation by MNCs is often conducted without evidence that it increases organizational efficiency (Oliver, 1997; Westphal et al., 1997; Yiu and Makino, 2002). When they perceive strong social pressure to adopt dominant practices, firms may place priority on legitimacy seeking over organizational efficiency concerns (Westphal et al., 1997). Dominant practices in the host country, however, may be incompatible with the MNCs resources and capabilities because their resources and capabilities have been developed within the institutional context of the home country that is different from the host country's institutional context (Auh and Menguc, 2009; Brouthers, Brouthers, and Werner, 2008). Dominant and socially appropriate practices in the host country may not support the efficient exploitation of MNCs' resources and capabilities that are transferred from the home country (Clark and Lengnick-Hall, 2012).

Consistent with these arguments, previous studies reported the negative relationship between isomorphic behavior and organizational performance. Zaheer (1995) surveyed Western and Japanese banks in the U.S. and Japan and found that foreign trading rooms that are distant from local practice perform better. In the context of Portuguese bank branching decisions, Barreto and Baden-Fuller (2006) showed the negative effect of isomorphic

behavior on the performance of banks. Westphal et al. (1997) used a dataset of hospitals in the U.S. and found that adoption of total quality management that are perceived as a normative practice increases the hospital's legitimacy but decreases its efficiency. These studies indicated that isomorphic behavior negatively affects organizational performance. Adequate knowledge about the economic consequences of isomorphic behavior by MNCs, however, has not been accumulated. There is still a research gap with regard to the examination of the effect of mimetic behavior by MNCs on organizational performance, which needs to be fulfilled.

### **HYPOTHESES**

Legitimacy of foreign entrants is improved by successfully responding to the social pressure from the local context (Deephouse and Carter, 2005; Scott, 2008). By mimicking the prevailing practice in the host country, foreign firms can reduce the institutional pressure from the social context of the host country, gain local legitimacy, and mitigate liabilities of foreignness (Deephouse and Carter, 2005; Salomon and Wu, 2012; Xu et al., 2004; Zaheer, 1995). However, efforts to adapt to the socially desirable practice may constrain the foreign firm's strategic discretion that is essential to raise efficiency and produce economic rents. Legitimacy seeking behavior may limit the strategic action of the foreign firm and prevent efficient and effective deployment of resources. Thus, the adoption of normatively rational action, which is the adoption of the socially desirable practice, makes it difficult for foreign firms to be economically rational (Oliver, 1997). In addition, the socially desirable practice may not be compatible with existing practices and resources of the foreign firm (Auh and Menguc, 2009). Due to misfit of the socially desirable practice with the resources and

practices of the foreign firm, its resources are not well exploited and its strategies are not well executed, which lower efficiency and erode economic rents. Thus, obtaining legitimacy incurs additional costs of adaptation to the host country's context, which undercut the efficiency of the firm (Yang, Su, and Fam, 2012).

These arguments imply the negative relationship between the imitation of the socially prevailing practice regarding foreign subsidiary staffing and the performance of the foreign subsidiary. When operating in the host country, MNCs face uncertainty and lack information about the PCN ratio that increases efficiency and effectiveness of the foreign operation (Chan et al., 2006). Under the condition of uncertainty, MNCs may imitate the PCN ratio that prevails in the host country without having evidence that the imitation increases the subsidiary's efficiency (Deephouse, 1996; DiMaggio and Powell, 1983; Salomon and Wu, 2012). The imitation of the dominant PCN ratio may improve legitimacy and acceptance of the foreign subsidiary and increase the likelihood of the subsidiary's survival through providing it with access to scarce local resources and information (Deephouse and Carter, 2005; DiMaggio and Powell, 1983; Kostova and Zaheer, 1999; Schmidt and Sofka, 2009; Scott, 2008). Increased legitimacy may also improve host country nationals' (HCNs) morale and commitment to the foreign subsidiary (Bonache Perez and Pla-Barber, 2005; Law, Song, Wong, and Chen, 2009; Widmier, Brouthers, and Beamish, 2008). Increased legitimacy, however, may be obtained at the cost of efficiency (Barreto and Baden-Fuller, 2006; Martinez and Dacin, 1999; Oliver, 1997). MNCs assign PCNs to foreign subsidiaries, primarily expecting them to execute knowledge transfer and control roles (Gaur et al., 2007; Gong, 2003; Tan and Mahoney, 2006). PCNs are used as a means to transfer firm-specific resources and capabilities to foreign subsidiaries because the resources and capabilities are embedded

in the organizational members (Wang, Tong, Chen and Kim, 2009). PCNs may have capabilities to exploit firm-specific resources in the host country to compete with local competitors and produce economic rents. They also share the values and goals of the parent firm and better understand the parent firm's strategies (Gong, 2003). This trait of PCNs enhances the parent firm's controllability over the foreign subsidiary and reduces agency costs (Gong, 2003). Although MNCs need to set an optimal PCN ratio to raise the effectiveness of knowledge transfer and control, the imitation of the prevailing PCN ratio to gain legitimacy prevents from setting the optimal PCN ratio and hinders the best use of PCNs' abilities. The dominant PCN ratio may not support the efficient and effective exploitation of the resources that are transferred from the parent firm and the implementation of the strategies assigned to the subsidiary (Clark and Lengnick-Hall, 2012). This inefficient deployment of human resources in search for local legitimacy is likely to lower the performance of the foreign subsidiaries. These arguments lead us to propose the following hypothesis.

Hypothesis 1 (H1): The imitation of the dominant PCN ratio in the host country is negatively associated with the performance of the foreign subsidiary.

Host countries where MNCs operate have a different institutional environment from the home country. Some host countries have similar institutions to the home country while others have dissimilar institutional environments that challenge MNCs. The degree of dissimilarity in institutions between two countries is termed institutional distance (Kostova and Zaheer, 1999; Xu and Shenkar, 2002). Institutional distance between a host country and a home country presents a degree of a challenge that MNCs face in establishing and maintaining

legitimacy in the host country (DiMaggio and Powell, 1983; Kostova and Zaheer, 1999; Scott, 2008; Xu and Shenkar, 2002). As institutional distance becomes great, the adoption of the socially desirable practice in the host country may cause significant loss of efficiency because the compatibility of MNCs' resources and practices with the local practices decreases (Brouthers et al., 2008; Kostova, 1999). Due to the incompatibility, the adoption of the dominant practice in institutionally distant countries may hinder the efficient implementation of the subsidiary's strategies (Clark and Lengnick-Hall, 2012). In addition, resources and practices of MNCs have been developed in their home country where institutional settings are different from host countries. Their resources and practices are designed to better produce economic rents within the home country institutions (Brouthers et al., 2008; Kostova, 1999). When institutional distance is great, incompatibility of MNCs' resources and practices with the host country's institutional context increases, which lowers efficiency in resource exploitation.

In the case of low institutional distance, subsidiaries of MNCs may have less difficulty in dealing with the institution of the host country due to its similarity with the home country (Brouthers et al., 2008; Estrin, Baghdasaryan, and Meyer, 2009). The resources that have been developed within the institutional setting of the home country can better produce economic rents because of their compatibility with the institutional environments of the host country (Brouthers et al., 2008). Even if MNCs adopt the prevailing practice in the host country to seek local legitimacy, loss of efficiency in strategy implementation and resource exploitation may be marginal (Brouthers et al., 2008; Estrin et al., 2009). Although the dominant PCN ratio in the host country may not be optimal to exploit resources that are transferred from the parent firm and to implement the subsidiary's strategies, the subsidiary

can manage to deal with the similar institutions to the home country and to mitigate inefficiency. Thus, in the case of institutionally similar host countries, imitating the prevailing PCN ratio may not incur large legitimacy costs and significant loss of efficiency.

In comparison, when large institutional distance exists between the host country and the home country, the cost to gain legitimacy may increase (Brouthers et al., 2008; Kostova and Zaheer, 1999; Xu et al., 2004). MNCs may sacrifice significant efficiency to meet the local legitimacy requirements. When the MNC adopts the prevailing PCN ratio that is perceived to be acceptable in the institutionally distant host country, the effectiveness of knowledge transfer and control may erode because deviation from the optimal PCN ratio for efficient operations causes inefficiency. In addition, because of difficulty in dealing with institutions dissimilar to the home country, resource exploitation and strategy implementation undermine when the PCN ratio deviates from the optimal level. Thus, in institutionally distant host countries, the cost for legitimacy seeking is larger and the adoption of the dominant PCN ratio accompanies significant loss of efficiency. These arguments lead to the following hypothesis.

Hypothesis 2 (H2): The relationship between the imitation of the dominant PCN ratio in the host country and the performance of the foreign subsidiary is negatively moderated by the institutional distance between the host country and the home country.

## **METHOD**

### ***Sample and dataset***

The hypotheses were tested using a sample that consists of the foreign subsidiaries of Japanese listed firms. The subsidiaries in the sample were identified using the *Kaigai*

*Shinshutsu Kigyō Soran* (Overseas Japanese Companies Data) compiled by Toyo Keizai Shimposha. Using the 1997, 1999, 2001, 2002, 2003, 2005, 2007 and 2008 editions of the data source, this study developed a panel dataset. The observation period was from 1997 to 2008. Primarily due to the unavailability of data and the entry and closure of foreign subsidiaries, the panel dataset of this study was unbalanced. Although the data source provided data on the foreign subsidiaries of unlisted firms, this study limited the sample to foreign subsidiaries owned by Japanese listed firms because the availability of the data regarding unlisted parent firms was limited. Both manufacturers and non-manufacturers were included in the initial sample. After removing the observations with missing data, the final sample included 3,284 subsidiaries across 63 countries. The number of observations in the panel dataset is 9,111.

### ***Measures***

The dependent variable of this study is the performance of foreign subsidiaries. Because the financial performance of foreign subsidiaries is often not disclosed or unavailable, this study adopted the labor productivity of foreign subsidiaries as a proxy for subsidiary performance by using available data (Gaur et al., 2007; Gong, 2003). The labor productivity was measured by foreign subsidiary sales per foreign subsidiary employee, which was log-transformed for analysis (Gaur et al., 2007; Gong, 2003). This study collected these data from the *Kaigai Shinshutsu Kigyō Soran*.

The PCN ratio was calculated as a ratio of the number of PCNs to the number of subsidiary employees. To operationalize the imitation of the dominant PCN ratio in the host country, this study employed the similar approach to Salomon and Wu (2012). First, this

study calculated the mean of the PCN ratio for each host country as the proxy for the dominant PCN ratio. Then, the mean of the PCN ratio for the host country was subtracted from the PCN ratio of the subsidiary operating in the country. The difference between the mean of the PCN ratio and the actual PCN ratio indicates deviation from the dominant PCN ratio. The absolute value of this difference was used as a proxy for the imitation of the dominant PCN ratio. To make larger scores represent the higher tendency to imitate the dominant PCN ratio, this study multiplied this absolute value by -1 (Salomon and Wu, 2012).

To operationalize the institutional distance between the host country and the home country, this study used data from the World Bank's Governance Indicators to measure the institutional distance, which is based on several hundred variables drawn from 37 separate data sources constructed by 31 organizations (Kaufmann, Kraay, and Mastruzzi, 2005). The governance indicators consist of six institutional dimensions: voice and accountability, political instability and violence, government effectiveness, regulatory burden, rule of law, and control and corruption. To operationalize the institutional distance, this study adopted Ando and Paik's (forthcoming) approach that is based on Kogut and Singh's (1988) method to measure cultural distance. Formally, this study used the following formula:

$$\text{Institutional Distance}_j = \frac{1}{6} \sum_{i=1}^6 \left\{ \frac{(I_{ij} - I_{ih})^2}{\sigma_i^2} \right\}$$

where institutional distance  $_j$  is the institutional distance between the host country  $j$  and Japan,  $I_{ij}$  is country  $j$ 's score on the  $i$ th institutional dimension,  $I_{ih}$  is Japan's score on the  $i$ th institutional dimension, and  $\sigma_i^2$  is the variance of the  $i$ th institutional dimension. To examine the validity of this proxy, correlation analyses were conducted between the institutional distance measure of this study and the other measures used in previous studies. The analyses demonstrated that the institutional distance variable of this study is significantly

and highly correlated with the other measures ( $r=.844$ ,  $p<.001$  for the measure by Chan, Isobe, and Makino (2008) and  $r=.739$ ,  $p<.001$  for the measure by Xu et al. (2004)).

Because the performance of foreign subsidiaries is affected by the attributes of the subsidiary itself, the parent firm, the industry in which the subsidiary is engaged, and the host country, this study controlled for these effects. As control variables at the subsidiary level, this study included the ownership structure of the foreign subsidiary and the size of the foreign subsidiary. The ownership structure of the foreign subsidiary was measured as the ratio of equity ownership in the subsidiary owned by the parent firm. When the foreign subsidiary is owned by more than one parent firm from the home country, we collected data only from the primary parent firm. This approach is also the case for the other control variables due to unavailability of data. The size of the foreign subsidiary was calculated as the number of the subsidiary's employees divided by the number of the parent firm's employees. This variable indicates the relative size of the foreign subsidiary. As control variables at the parent firm level, the R&D intensity, the advertisement intensity, the foreign sales ratio, the host country experience, and the performance of the parent firm were incorporated. The R&D intensity of the parent firm was measured by the ratio of R&D expenditure to total sales. Similarly, the advertisement intensity was measured by the advertisement expenditure to total sales. The host country experience of the parent firm was measured as the sum of the operation years for the foreign subsidiaries operating in the host country. The scores for the host country experience were log-transformed when they were incorporated into the analysis. The foreign sales ratio of the parent firm was calculated as the ratio of foreign sales to total sales. To measure the performance of the parent firm, this study used operating income margin, which was calculated as the operating income on sales. To

control for industry effects, this study used the industry of the foreign subsidiary, which was a dummy variable that takes a value of 1 when the foreign subsidiary is engaged in the manufacturing sector and a value of 0 when it is engaged in the service sector. As explained below, this study adopts a fixed effect model to analyze the panel dataset. The fixed effect model cannot include time-invariant regressors. Therefore, to include a dummy variable that represents the industry of the foreign subsidiary, this study multiplied the industry dummy variable by the year dummy variables. To control for the host country effects, this study incorporated the GDP of the host country. The growth rate of GDP per capita was incorporated into the analysis.

### *Analytical method*

This study adopted panel data models. Panel data models have an advantage over cross sectional models in that the panel data models can account for unobserved individual specific effects (in this study, unobserved individual subsidiary-specific effects) (Wooldridge, 2010). The  $F$  test was conducted to determine whether a fixed effect model would be more appropriate than a pooled ordinary least squares (OLS) model. The result of the  $F$  test rejected the null hypothesis that the individual effect does not vary across units ( $F=11.93$ ,  $p<0.001$ ). The rejection of the null hypothesis indicates that a fixed effect model is more appropriate than a pooled OLS model. Next, this study examined whether a random effect model would be more appropriate than a pooled OLS model. The result of the Breusch-Pagan Lagrangian multiplier test rejected the null hypothesis that all variance of the individual effect is zero ( $\chi^2=5669.21$ ,  $p<0.001$ ). This result indicates that a random effect model is more appropriate than a pooled OLS model. This study then compared a fixed effect model with a

random effect model. The result of the Hausman test rejected the null hypothesis that the estimates from a fixed effect model are not different from the estimates by a random effect model ( $\chi^2=294.21, p<0.001$ ), which indicates that a fixed effect model is preferred. Based on these results, this study adopted a fixed effect model to test the hypotheses. Because this study adopted a fixed effect model, time invariant variables were not included in the analysis.

## RESULTS

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Insert Tables 1 and 2  
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Table 1 reports the descriptive statistics and correlation coefficients of the variables used in this study. In the sample, the average PCN ratio was 9.4 percent and the average number of PCNs assigned to a foreign subsidiary was 4. The mean values for the foreign subsidiary's age and number of employees were 14.4 and 268, respectively. In the sample, 46.3 percent of the foreign subsidiaries were wholly owned. The correlation coefficients shown in Table 1 were low overall. Thus, it is less likely that a severe multicollinearity problem is present.

Table 2 reports the results of the fixed effect models. Model 1 included only the moderator and the control variables and in Model 2, the imitation of the dominant PCN ratio in the host country was added. Model 3 included the interaction between the imitation of the dominant PCN ratio in the host country and institutional distance between the host country and the home country. Model 2 showed that the imitation of the dominant PCN ratio has a significant and negative effect on foreign subsidiary performance ( $b = -0.720, p < .001$ ). This result supports H1 that expects the negative relationship between the imitation of the dominant

PCN ratio and the subsidiary performance. Model 3 tested H2 that expects the negative moderating effect of institutional distance for the relationship between the imitation of the dominant PCN ratio and the subsidiary performance. The result showed that the coefficient of the interaction term is significant and negative ( $b = -.332, p < .05$ ). The result lent support to H2. Figure 1 depicts a graphical presentation of the moderating effect of institutional distance for the relationship between the imitation of the dominant PCN ratio and the subsidiary performance.

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Insert Figure 1  
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Regarding the control variables, the foreign sales ratio, the host country experience, and the performance of the parent firm were consistently significant and positive through Models 1 to 3. In comparison, the relative size of the foreign subsidiary was consistently significant and negative for all models. The results showed that institutional distance itself has the significant and negative impact on the subsidiary performance.

## **DISCUSSION AND CONCLUSION**

This study examined how isomorphic behavior regarding foreign subsidiary staffing influences subsidiary performance. The results obtained from the analysis of the panel data that consists of 3,284 foreign subsidiaries of Japanese firms indicates that setting the PCN ratio of the foreign subsidiary closer to the dominant PCN ratio in the host country negatively affects the subsidiary performance. The results also indicated that the relationship between the imitation of the dominant PCN ratio and subsidiary performance is negatively moderated

by institutional distance between the host country and the home country. In institutionally distant countries, the imitation of the prevailing PCN ratio more worsens the subsidiary performance. Although previous studies empirically showed that MNCs adopt isomorphic behavior in pursuit of legitimacy within the host country, the consequences of isomorphic behavior by MNCs have been uncovered. This study contributes to the literature by providing empirical evidence of the negative relationship between isomorphic behavior and performance in the context of international business. In addition to this direct effect, the study also empirically shows the moderating effect of institutional distance.

The results of this study imply that isomorphic behavior in pursuit of legitimacy negatively affects the performance of foreign subsidiaries. Foreign subsidiaries are confronted with liabilities of foreignness and a lack of legitimacy in the host country. To mitigate institutional pressure and overcome liabilities of foreignness, foreign subsidiaries need to adopt the PCN ratio that is considered socially desirable in the host country. Mimicking the desirable PCN ratio may enhance the foreign subsidiary's acceptance in the host country and increase its legitimacy. However, the results of this study imply that gaining legitimacy is accompanied by the cost, which is loss of efficiency and effectiveness. The adoption of the dominant practice is normatively rational but the action is not necessarily economically rational (Oliver, 1997; Westphal et al., 1997). An economic imperative requires MNCs to set an optimal PCN ratio, which ensures the effective transfer and exploitation of resources and capabilities and the effective control over subsidiary operations. Legitimacy seeking through imitating the dominant PCN ratio, however, may lead to the deviation from the economically rational PCN ratio for the subsidiary. The deviation from the economically rational practice prevents the subsidiary from effective implementation of subsidiary

operations, which weakens competitiveness of the subsidiary. As a result, subsidiary performance lowers in exchange for increased legitimacy in the host country. The results of this study imply that legitimacy seeking through imitating other firms' practice is conducted at the cost of economic rent seeking.

This study found the factor that moderates the negative relationship between isomorphic behavior and performance. The results showed that institutional distance between the host country and the home country alters a degree of efficiency loss caused by legitimacy seeking. The results indicate that the negative effect of the imitation of the dominant practice on subsidiary performance is greater as institutional distance increases. This implies that the loss of efficiency that is caused by legitimacy seeking is greater when the foreign subsidiary operates in an institutionally distant country. In institutionally similar environments, MNCs may perceive less legitimacy pressure (Yang et al., 2012). In addition, they can better deal with local institutions because of the similarity to the home country. In such an environment, foreign subsidiaries may marginally lose efficiency even if they pursue legitimacy by mimicking the PCN ratio of other foreign firms. Thus, even though the dominant practice is away from the subsidiary's optimal PCN ratio, the subsidiary can manage to exploit resources and capabilities and produce economic rents. In the case where institutional distance is low, it is likely that foreign subsidiaries can simultaneously seek legitimacy and economic efficiency with less legitimacy cost. In comparison, MNCs need to gain legitimacy by adopting the dominant PCN ratio when they face greater institutional distance. However, the results indicate that legitimacy seeking in institutionally distant countries comes with greater loss of efficiency. Due to deviation from an optimal PCN ratio for the subsidiary, MNCs cannot well exploit their resources and capabilities and well maintain controllability over foreign

operations, which lowers subsidiary performance. Thus, in institutionally distant countries, legitimacy is gained in exchange for greater legitimacy costs. The results of this study suggest that the cost of legitimacy seeking varies depending on institutional distance between the host country and the home country.

Managers in charge of foreign subsidiary staffing need to consider a cost side of legitimacy seeking. Adopting the socially desirable practice may help the foreign subsidiary gain legitimacy from the host country. However, it is accompanied by loss of economic efficiency. For the subsidiary to successfully implement strategies assigned by the parent firm, it is required to set an optimal PCN ratio that may deviate from the socially desirable practice. Adoption of the optimal ratio may, in turn, undermine acceptance and legitimacy within the host country. Managers need to balance legitimacy against efficiency. Balancing these two is more difficult in institutionally distant countries. When facing great institutional distance in the host country, the subsidiary incurs more legitimacy costs. In institutionally distant countries, however, gaining legitimacy is more important for the subsidiary to survive (Xu et al., 2004). Therefore, MNCs operating in institutionally distant countries may need to acquire local knowledge and familiarize themselves with local institutions to better balance legitimacy against economic efficiency.

This study is subject to several limitations. The sample used in this study consists solely of foreign subsidiaries of Japanese firms. This research design limits the generalizability of the findings from this study. The results obtained from this study may change when data of European or U.S. MNCs are used. Thus, future research may replicate this study using datasets of MNCs from other countries. This study operationalized a dominant PCN ratio as the average PCN ratio of foreign subsidiaries in each host country. Then, this study calculated

the absolute difference between the PCN ratio of each subsidiary and the host country's average score. This operationalization is a similar approach to Salomon and Wu (2012). However, future studies need to improve the operationalization of a dominant practice and a degree of isomorphic behavior. In addition, because of unavailability of data, we used labor productivity as a proxy for subsidiary performance. The measure may capture limited aspects of performance of foreign subsidiaries. Future studies may use other measures of subsidiary performance such as ROI or ROA. Finally, this study only considered institutional distance as a moderator for the relationship between isomorphic behavior and subsidiary performance. Future studies need to extend this study by exploring another moderator.

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**Table 1. Descriptive statistics and correlation coefficients**

	Mean	S.D.	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18
1 Subsidiary Performance	5.322	1.693	1.000																	
2 Imitation of the dominant practice	-0.113	0.122	-0.275	1.000																
3 Institutional distance	1.184	1.208	-0.559	0.301	1.000															
4 Ownership in subsidiary	0.667	0.381	0.144	-0.110	-0.101	1.000														
5 Size of subsidiary	0.058	0.207	-0.215	0.046	0.119	0.000	1.000													
6 R&D intensity	0.033	0.028	0.148	0.030	-0.112	-0.044	-0.073	1.000												
7 Advertisement intensity	0.011	0.018	0.022	0.016	-0.088	-0.037	-0.019	0.078	1.000											
8 Foreign sales ratio	0.307	0.278	0.178	0.037	-0.088	-0.028	-0.044	0.210	0.010	1.000										
9 Host country experience	3.021	0.905	0.136	-0.070	-0.127	-0.155	-0.049	0.153	0.025	0.116	1.000									
10 Parent firm performance	0.053	0.047	0.011	0.040	-0.030	0.029	0.031	0.131	0.111	0.095	-0.086	1.000								
11 Growth of GDP	3.639	4.217	-0.222	0.095	0.398	-0.015	0.060	-0.084	-0.048	0.064	-0.005	0.010	1.000							
12 Year 99 * manufacturer	0.043	0.204	-0.112	0.051	0.036	-0.044	0.021	0.028	-0.020	-0.235	-0.042	0.035	-0.322	1.000						
13 Year 01 * manufacturer	0.076	0.264	-0.154	0.083	0.111	-0.049	0.027	-0.029	-0.054	-0.047	-0.041	-0.062	0.087	-0.061	1.000					
14 Year 02 * manufacturer	0.085	0.278	-0.161	0.083	0.140	-0.057	0.036	-0.046	-0.030	-0.045	-0.029	-0.011	-0.092	-0.065	-0.087	1.000				
15 Year 03 * manufacturer	0.080	0.271	-0.153	0.063	0.084	-0.039	0.060	-0.015	-0.019	-0.027	-0.028	-0.135	0.023	-0.063	-0.084	-0.089	1.000			
16 Year 05 * manufacturer	0.073	0.260	-0.140	0.059	0.109	-0.037	0.077	-0.019	-0.033	0.009	0.019	0.018	0.134	-0.060	-0.080	-0.085	-0.082	1.000		
17 Year 07 * manufacturer	0.077	0.267	-0.107	0.042	0.094	-0.006	0.095	-0.079	-0.024	0.040	0.020	0.057	0.160	-0.062	-0.083	-0.088	-0.085	-0.081	1.000	
18 Year 08 * manufacturer	0.085	0.278	-0.100	0.044	0.121	-0.006	0.062	-0.053	-0.055	0.056	0.038	0.060	0.219	-0.065	-0.087	-0.092	-0.089	-0.085	-0.088	1.000

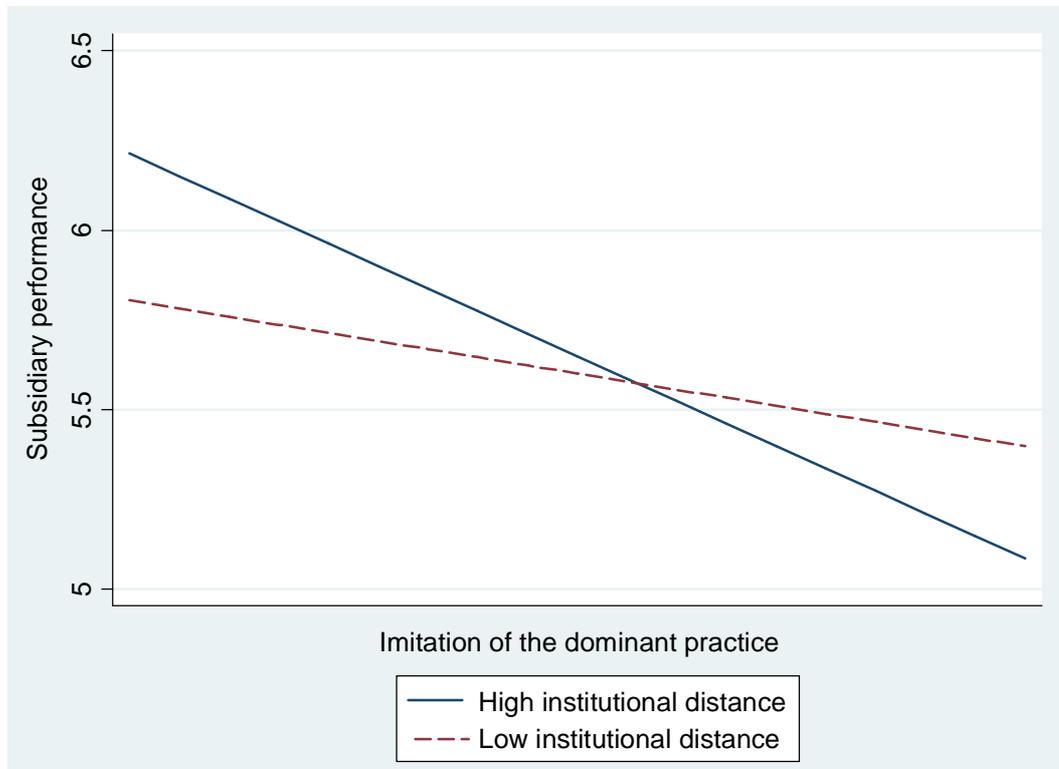
Note: Correlations equal or greater than  $|0.021|$  are significant at  $p < 0.05$ .

**Table 2. Results of fixed effect models**

	Model 1			Model 2			Model 3		
	b		S.E.	b	S.E.		b		S.E.
Imitation of the dominant practice				-0.720	***	0.132	-0.460	**	0.176
Institutional distance	-0.088	*	0.044	-0.100	*	0.044	-0.129	**	0.046
Imitation of the dominant practice * Institutional distance							-0.332	*	0.148
Ownership in subsidiary	-0.082		0.069	-0.087		0.069	-0.088		0.069
Size of subsidiary	-0.446	***	0.082	-0.447	***	0.082	-0.446	***	0.082
R&D intensity	0.530		1.193	0.640		1.190	0.686		1.190
Advertisement intensity	0.888		2.938	0.592		2.931	0.685		2.930
Foreign sales ratio	0.237	***	0.043	0.239	***	0.043	0.241	***	0.043
Host country experience	0.269	***	0.032	0.261	***	0.032	0.257	***	0.032
Parent firm performance	2.159	***	0.288	2.190	***	0.287	2.190	***	0.287
Growth of GDP	0.004		0.003	0.003		0.003	0.003		0.003
Year 99 * manufacturer	-0.241	*	0.095	-0.230	*	0.095	-0.232	*	0.095
Year 01 * manufacturer	-0.267	**	0.087	-0.253	**	0.087	-0.248	**	0.087
Year 02 * manufacturer	-0.196	*	0.086	-0.185	*	0.086	-0.181	*	0.086
Year 03 * manufacturer	-0.229	**	0.086	-0.222	**	0.086	-0.223	**	0.086
Year 05 * manufacturer	-0.186	*	0.086	-0.177	*	0.086	-0.177	*	0.086
Year 07 * manufacturer	-0.046		0.087	-0.040		0.087	-0.041		0.087
Year 08 * manufacturer	0.078		0.088	0.081		0.088	0.078		0.088
Constant	4.542	***	0.135	4.496	***	0.135	4.542	***	0.136
R squared									
Within	0.090			0.095			0.096		
Between	0.156			0.201			0.206		
Overall	0.181			0.223			0.228		
F	36.111	***		35.898	***		34.206	***	
Observation	9111			9111			9111		

\*\*\*  $p < .001$ ; \*\*  $p < .01$ ; \*  $p < .05$

**Figure 1. The interaction effect of the imitation of the dominant practice and the institutional distance.**



Note: High institutional distance represents the mean + one standard deviation and low institutional distance represents the mean - one standard deviation.



本ワーキングペーパーの掲載内容については、著編者が責任を負うものとします。

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