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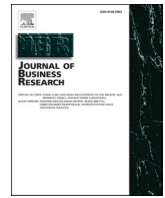
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## Subsidiary staffing, location choice, and shareholder rights effectiveness

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### ABSTRACT

Institutional differences between countries influence strategic choices and performance of international businesses, but the unintended effects of legal institutions on firm legitimacy have received less attention. We argue that, while minority shareholder rights protection in an investment location does not directly protect shareholder interests abroad, the normative and mimetic effects it has on host country managers can mitigate agency problems. Using Japanese FDI established between 1986 and 2013 we find that (a) subsidiaries established in host countries with higher shareholder rights protection employ a smaller proportion of Japanese expatriates, (b) shareholder rights protection enhances a country's FDI attractiveness, and (c) that the impacts of shareholder rights protection on expatriate ratio and location attractiveness are stronger when firm ownership is concentrated among exchange-listed firms. This research contributes to the literature on institutional difference in international business, in particular by highlighting the value of studying the imprinting effects of regulations.

### 1. Introduction

Differences between home and host country institutional environments shape foreign direct investment (FDI) decisions including location choice and entry mode, and outcomes such as performance and survival (Johanson & Vahlne, 1977; Trapczynski & Banalieva, 2016; Zaheer, Nachum, & Schomaker, 2012). Formal institutional differences (i.e. legal and regulatory environments) increase the complexity of managing foreign subsidiaries (Cuypers, Hennart, Silverman, & Ertug, 2021; Dunning, 1988) and both formal and informal (i.e. cultural) institutional environments necessitate strategic adaption (Chuck & Solomon, 2006). Institutional *similarities*, on the other hand, ease the diffusion of MNEs' knowledge and practices between headquarters and subsidiaries (Kostova, 1999; Kostova & Roth, 2002).

Building on prior research (Kostova, Beugelsdijk, Scott, Kunst, Chua, & van Essen, 2020) we argue that *formal* regulations can create *informal* institutional pressures on decision-making in the MNE. Specifically, minority shareholder rights (SHR) protection lowers the risk of managerial misappropriation of firm assets due to *imprinting* effects on host country management norms and practices (Konara & Shirodkar, 2018; Popli, Raithatha, & Fuad, 2021; Stinchcombe, 1965). As a result, the MNE prefers FDI locations with stronger SHR protection (Globerman & Shapiro, 2003; Lskavyan & Spatareanu, 2011), and uses fewer expatriate

managers to staff subsidiaries in these locations. Since MNE governance is influenced by SHR in the home country, we predict that its relationships with subsidiary staffing and location attractiveness are stronger when a greater share of the subsidiary is owned by exchange-listed firms.

We test our hypotheses on Japanese overseas subsidiaries founded during the period 1986–2013. Using fractional regression, implemented via heteroskedastic probit modelling, we find a negative relationship between host-country SHR and the ratio of Japanese expatriates to total employees of the foreign subsidiary. Using mixed-effects discrete choice modeling techniques, we consequently find that countries with stronger SHR are more likely to be chosen for investment. Finally, expatriate ratio is lower, while locations are more attractive to FDI, when there is a greater share of subsidiary ownership held by Japanese parent firm listed on the Tokyo Stock Exchange (TSE). This latter finding reinforces our argument that the impact of formal regulations diffuses to shape management norms for the country.

This research extends prior research on the relationship between SHR and location choice (e.g. Baulkaran & Lupton, 2020; Globerman & Shapiro, 2003; Wang, Alba, & Park, 2012) and further probes how it impacts an MNE's subsidiary staffing practices (Guillén & Capron, 2016). In particular, we introduce mimetic and normative pressures as mechanisms explaining why SHR congruence between home and host

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FDI countries impacts FDI, despite the fact that foreign shareholders are outside the jurisdiction of the laws in question. We further demonstrate that coercive pressures in the FDI home country interact with those normative and mimetic forces in the host country to enhance the FDI-attractiveness of SHR and expatriate staffing levels. This research contributes to the call to consider the impact of institutional environments on international business from multiple institutional lenses (Kostova et al., 2020; Shin, Hasse, & Schotter, 2017). We also contribute to recent research that has highlighted the need to distinguish public from private expropriation risk in international business decisions (Sartor & Beamish, 2019), by demonstrating that MNE concerns for retaining control over foreign subsidiaries through expatriate deployment may be alleviated by strong SHR protection in the host country. Finally, our findings have implications for MNE investors and policymakers on how host country SHR can attract FDI while increasing opportunities for local management talent.

## 2. Theory and hypotheses

### 2.1. Institutional differences in international business

International business is fundamentally concerned with the management of physical and institutional distances (Zaheer et al., 2012). Three theoretical perspectives on institutional distance – i.e. the contextual differences between countries originating in social, cultural, legal, historical and economic systems – have been influential in explaining international business location, decision-making and performance (Kostova et al., 2020). These are organizational institutionalism, institutional economics, and comparative institutionalism. Both organizational institutionalism and institutional economics are concerned with how the degree of congruence between the internal and external governance environments influence MNE behavior. According to organizational institutionalism, these behaviors are based on the need

for gaining legitimacy and easing access to resources, while in institutional economics, the goal is to economize on transaction costs. Comparative institutionalism is less relevant in this study, being primarily concerned with the categorization and performance of political economies (La Porta, Lopez-de-Silanes, Shleifer, & Vishny, 1998).

*Organizational institutionalism (OI)* acknowledges that the firm is embedded within a social context that influences its behavior, performance and survival (Meyer & Rowan, 1977; Scott, 2008). The MNE is embedded in multiple social contexts (Saka-Helmhout, Deeg, & Greenwood, 2016), and MNE subsidiaries are *dually* embedded in their local and MNE environments (Andersson & Forsgren, 1996; Oehmichen & Puck, 2016). According to OI, MNEs face a liability of foreignness (Coviello, Kano, & Liesch, 2017; Johanson & Vahlne, 1977) which complicates embedding and legitimation, threatening firm survival through resource attraction problems and performance decline. The institutional forces influencing firms are divided into regulatory (responding to coercive pressures), cognitive (inducing imitation of exemplars) and normative (conforming to widely accepted practices) (Meyer & Rowan, 1977; Scott, 2008).

*Institutional economics (IE)* views legal and normative pressures as forming the ‘rules of the game’ for business, which shape MNE location preferences and transaction modes (Buckley, 2009; Dunning, 2000; North, 1990). According to IE theories, such as transaction cost economics and agency theory (Eisenhardt, 1989; Williamson, 1985), the main drivers of MNE behaviors, governance modes and performance are the costs of negotiation, monitoring and enforcing contracts (Cuypers et al., 2021; Filatotchev & Wright, 2011), rather than the legitimacy and embedding processes of OI (Suchman, 1995). Intuitively, an IE perspective sheds light on why SHR is attractive to FDI, but we argue that legal mechanisms are limited to the extent that shareholders are outside the jurisdiction of the laws. Hence, we combine insights from IE and OI perspectives to explain the impact of SHR on the behavior of the MNE. Fig. 1 graphically depicts the complementary influences of

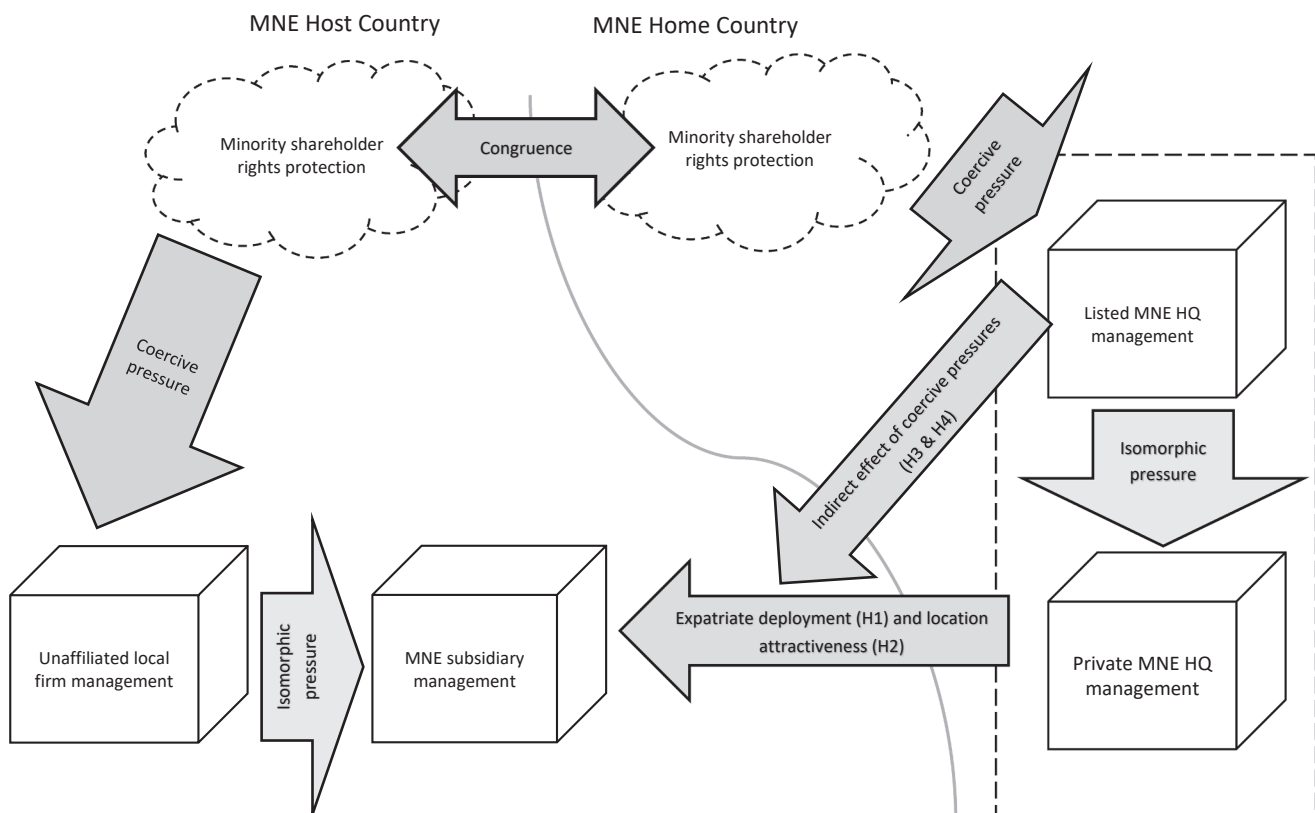


Fig. 1. The regulatory and normative roles of shareholder rights protection (SHR) on subsidiary staffing and location.

country and firm institutional environments on the staffing and location of MNE subsidiaries.

## 2.2. Shareholder rights protection (SHR) and subsidiary staffing

According to OI, organizations face coercive, normative and cognitive pressures for conformance (Scott, 2008). In the current study, coercive forces shape subsidiary governance through the laws and regulatory bodies in the host country, in addition to policies imposed by the MNE. Normative pressures arising from the broader social context influence subsidiary managers' perceptions of the legitimacy of varying management practices (Deephouse, Bundy, Tost, & Suchman, 2017). Finally, cognitive pressures can shape behavior where coercive and normative pressures are absent or equivocal. When in doubt, subsidiary managers rely on their own and others' experience to guide their governance practices. To the extent that MNE subsidiary HR practices are embedded within their local context, they will conform with host country norms (Björkman, Fey, & Park, 2007).

MNEs span institutional boundaries (Kostova & Zaheer, 1999) creating the problem of *institutional duality* for foreign subsidiaries embedded within both local and MNE contexts. This is evident in subsidiaries' responses to political activity (Hillman & Wan, 2005), increased difficulty in transferring complex knowledge between MNE subunits (Kostova & Roth, 2002; Minbaeva, Pedersen, Björkman, Fey, & Park, 2003) and implementing MNE initiatives abroad (Beddewela, 2019). Subsidiary managers' priorities are influenced by their home country institutions, including government, education, and those of customers, suppliers, and peers. Hence, creating pressures for subsidiary isomorphism, which may conflict with MNE headquarter interests.

Deploying expatriates from the headquarter country to the local subsidiary is a common approach to mitigating information asymmetry, undesirable autonomy, and subsidiary isolation (Gaur, Delios, & Singh, 2007). Expatriates have a better understanding of MNE strategy, the intended role of the subsidiary, and the MNE's governance practices (Gong, 2003). Hence, expatriates can be effective in transferring MNEs' shareholder-friendly governance practices (Kostova & Roth, 2002). Due to the relative ease with which knowledge and MNE practices are transferred, expatriate deployment is a common tactic in subsidiary governance (Brock, Shenkar, Shoham, & Siscovick, 2008; Meyer, Li, & Schotter, 2020; Shin et al., 2017). In the absence of regulatory oversight from the MNE headquarters, subsidiaries may gravitate towards practices more common in the host country (Kim, Kim, Marshall, & Afzali, 2018). This is because mimetic isomorphism (i.e. conforming to normative and cognitive expectations) within the local environment confers legitimacy from the perspective of host country stakeholders (Banerjee & Venaik, 2018; Chapman, Sisk, Schatten, & Miles, 2018). Where local isomorphic pressures are high, the MNE's control over the subsidiary's behavior may wane (Beddewela, 2019). Deploying expatriate managers can mitigate this hazard (Rickley & Karim, 2018), but adds substantial management costs (Roth & O'Donnell, 1996; Suutari & Tornikoski, 2001).

With more stringent SHR, we expect that local management practices will become more aligned with MNE headquarters. Since the regulatory environment already favors shareholder rights, it exerts pressure on local managers to align with shareholders, thus reducing the need and cost of monitoring. Thus, in the absence of any other pressures, managers will be more likely to conform to their initial conditioning. This occurs naturally through imprinting, in which cognitive frames are created and guide interpretations of appropriate management practices (Konara & Shirodkar, 2018; Stinchcombe, 1965). Hence, we predict that in host countries with higher shareholder rights protection, MNEs will dispatch fewer expatriates:

**Hypothesis 1.** *The strength of host-country shareholder rights protection is negatively related to the proportion of Japanese expatriate managers in Japanese foreign subsidiaries.*

## 2.3. FDI location attractiveness of shareholder rights protection

Unlike expatriate staffing, the reason why MNEs prefer stronger SHR protection is less obvious. Lskavyan and Spatareanu (2011) debated whether weaker shareholder protection would either encourage more FDI, due to less stringent monitoring, or discourage it due to increased agency costs. Yet, these authors and others (Globberman & Shapiro, 2003; Guillén & Capron, 2016) have found that SHR is attractive to FDI, based on its ability to mitigate expropriation risk. We argue that this association is due to isomorphic forces rather than regulatory pressures. Implementing and enforcing MNE governance practices in foreign subsidiaries can be hampered by local norms related to managerial perquisites, nepotism, and weak control of corruption (Cuervo-Cazurra, 2016; Rabbiosi & Santangelo, 2019; Yi, Meng, Macaulay, & Peng, 2019). Additionally, mechanisms to align the interest of subsidiary managers with shareholders of the MNE can be costly to implement and ineffective due to information asymmetries arising from institutional duality (Kim et al., 2018; Kostova & Roth, 2002). Hence, monitoring and enforcing employment contracts is less costly when local management practices are aligned with MNE interests.

Our argument that MNEs will employ fewer expatriates to countries with stronger SHR protection also implies that, other things equal, those locations will be more attractive, given the incremental costs of expatriate deployment, such as wage premiums. Furthermore, a higher degree of SHR confers legitimacy to the location for the purpose of direct investment (Peng, 2012; Rabbiosi & Santangelo, 2019). We predict that legitimacy, combined with economizing on governance costs, improves the odds that an MNE will select a location for investment.

**Hypothesis 2.** *All else equal, the strength of shareholder rights protection increases the attractiveness of a potential host country for FDI.*

## 2.4. Japanese listed MNE ownership, subsidiary staffing, and location attractiveness

We have predicted that MNEs will use fewer expatriates in proportion to total employees when SHR protection is higher (Hypothesis 1) and are thus more likely to invest in countries with higher SHR (Hypothesis 2). Both predictions are consistent with the more generalized finding that firms gravitate towards environments similar to those at home (Mingo, Junkunc, & Morales, 2018; Slangen & Beugelsdijk, 2010). A key assumption of our predictions is that the Japanese MNE governance practices are influenced by SHR regulations at home, and these practices also shape staffing policies abroad. This assumption is consistent with prior research which demonstrates that MNEs align with regulatory pressures from their home countries (Barnard & Luiz, 2018; Martínez-Ferrero & García-Sánchez, 2017) and are thus aligned with shareholder interests when investing abroad. Here we argue that regulatory (i.e. coercive) pressures on governance practices are more influential on MNEs than the normative and mimetic pressures, because coercive forces precede the normative diffusion of managerial practices through socialization pressures (see Fig. 1, "isomorphic pressures"). Publicly listed MNEs face greater coercive pressures because they are regulated by legal institutions which protect shareholders' claims to the assets of the firm and their use in FDI (Lien & Filatotchev, 2015; Lien, Piesse, Strange, & Filatotchev, 2005). However, not all MNEs are publicly held, and consequently don't face the same degree of regulatory pressure to conform with shareholder interests. Hence, it follows that if Japanese MNEs prefer governance practices that favor minority shareholder interests, this preference will be stronger for listed companies compared to non-listed companies.

Alignment between shareholders and managers in international business can be achieved through equity ownership of foreign wholly-owned subsidiaries and international joint ventures (Filatotchev & Wright, 2011). However, we argue that strong SHR protection in both the home and host FDI country results can further align shareholder and

manger interests, as a result of imprinting (Konara & Shirodkar, 2018; Stinchcombe, 1965). Hence, MNEs without shareholders still prefer countries with stronger SHR protection, but not to the same extent as listed firms.

Listed ownership by Japanese firms is a continuum, as subsidiaries can be jointly owned by more than one parent firm, including combinations of listed and unlisted firms. Hence, to further test the assumption that SHR influences MNEs' use of expatriates, we predict that the negative relationship between SHR and expatriate ratio will be stronger (more negative) when the proportion of the subsidiary owned by TSE-listed Japanese firms is higher (Hypothesis 3). Likewise, we predict that the relationship between SHR and location attractiveness will be stronger when ownership by listed firms is higher (Hypothesis 4).

**Hypothesis 3.** *The negative relationship between host-country SHR and Japanese expatriate ratio is strengthened in proportion to the TSE-listed company share of equity in foreign subsidiaries.*

**Hypothesis 4.** *The positive relationship between host-country SHR and JFDI attractiveness is strengthened in proportion to the TSE-listed company share of equity in foreign subsidiaries.*

### 3. Method

#### 3.1. Sample

Our data are drawn from the *Kaigai Shinsutsu Kigyō Souran* (Japanese Overseas Investment), an annual survey compiled by Toyo Keizai (TK database). We use the 2014 edition, which provides a near-population of Japanese foreign investments made up to that year. To capture the significant rise in Japanese investment precipitating from the US Plaza Accord in 1985, we focus on the period 1986–2013 (Yamawaki, 2007). During this period, a total of 37,895 subsidiaries were established in 144 countries. We eliminated small-island developing nations which are typically considered 'flags of convenience' rather than locations for FDI that involves significant economic activity. This reduced our sample to 25,953 subsidiaries in 108 countries. Accounting for missing data, our final dataset was an unbalanced panel of 25,518 subsidiaries established over a 28-year period, selecting from amongst 34–64 alternative countries for investment<sup>1</sup>. The sample for the governance model contains fewer countries, and consequently a smaller sample of 23,616 subsidiaries, owing to missing data at the time of observation, rather than the time of subsidiary establishment<sup>2</sup>. Our final samples of subsidiaries were thus fairly representative of all Japanese FDI. The number of countries is more important for the location choice analysis we conduct, but our method is robust to both the presence or absence of unchosen alternatives.

The TK database provides several important characteristics of JFDI that cannot be determined from aggregate country-level FDI. First, each investment is individually observed according to its year and month of establishment, its location (i.e. country) of establishment, and the identity of its parent firms. The latter is important for disaggregating the effect of agglomeration (i.e. FDI stocks) as attractors of new investment from the impact of SHR. The country and year of establishment allow us

<sup>1</sup> Countries include: Algeria, Argentina, Australia, Austria, Bangladesh, Belgium, Brazil, Bulgaria, Canada, Chile, China, Colombia, Costa Rica, Czech Republic, Denmark, Egypt, El Salvador, Finland, France, Georgia, Germany, Ghana, Guatemala, Hong Kong, India, Indonesia, Italy, Jordan, Kazakhstan, Kenya, Korea, Lebanon, Lithuania, Luxembourg, Macau, Malaysia, Mexico, Nepal, Netherlands, New Zealand, Nigeria, Norway, Oman, Pakistan, Panama, Peru, Philippines, Poland, Portugal, Russia, Singapore, Slovenia, South Africa, Spain, Sweden, Switzerland, Taiwan, Thailand, Turkey, UAE, Ukraine, United Kingdom, USA, Venezuela, Vietnam.

<sup>2</sup> Governance model does not contain subsidiaries from: Georgia, Ghana, Lebanon, Macao, Nepal, and New Zealand.

to observe time-varying measures of SHR effectiveness and other location attributes known to influence FDI location decisions. Of particular importance to our study, we are able to obtain subsidiary-specific data to calculate the Japanese expatriate to total employee ratio and the ownership share of Japanese parent firms which are listed on the TSE.

#### 3.2. Dependent variables

##### 3.2.1. Expatriate ratio

For hypotheses 1 and 3, the dependent variable is Japanese expatriate ratio defined as the number of Japanese employees dispatched to each subsidiary divided by the total number of employees. Both of these variables are time-varying indicators obtained from the TK database.

##### 3.2.2. Entry

The variable of interest in hypotheses 2 and 4 is location attractiveness, a binary variable. The dataset is expanded so that, for each investment, both the chosen location (Entry = 1) and counterfactual locations (Entry = 0) comprise the full choice set.

#### 3.3. Independent variables

##### 3.3.1. Shareholder rights protection (SHR)

Our measure of SHR is the index constructed by Guillén and Capron (2016), which covers 78 least-developed, emerging, and developed countries between 1970 and 2016. Unlike previous measures of minority shareholder rights protection, such as La Porta et al. (1998) and Lele and Siems (2007), Guillén and Capron's longitudinal index spans more years and countries. As such, it tracks considerable changes in minority shareholder rights over the past 40 years, overcoming the limitations of cross-sectional measures (La Porta, Lopez-de-Silanes, & Shleifer, 2008; La Porta et al., 1998).

Guillén and Capron's measure comprises ten legal provisions for protecting minority shareholder rights, identified to be the most relevant by legal scholars (Lele & Siems, 2007; Siems, 2008). It includes powers of general meeting for de facto changes, agenda-setting power, anticipation of shareholder decision facilitation, prohibition of multiple voting rights, independent board members, feasibility of directors' dismissal, private enforcement of directors' duties (derivative suit), shareholder action against resolutions of the general meeting, mandatory bid, and disclosure of major share ownership (Guillén & Capron, 2016). 52 coders, each holding a J.D. from their home country, and are experts in the corporate legislation, participated in the data collection. This measure covers countries accounting for about 95 percent of the total world GDP, in 2011.

##### 3.3.2. Listed parent ownership

Our measure of listed ownership is calculated from the individual ownership shares of Japanese parents recorded in the TK database. We aggregated each fraction of ownership held by Japanese parents listed on the TSE. The remaining share is held by unlisted Japanese and non-Japanese (typically local) firms.

#### 3.4. Controls

Our model for testing hypotheses 1 and 3 included several control variables to account for alternate effects on the Japanese expatriate ratio. We use GDP per capita, as more developed countries are more attractive for expatriates, and hiring local managers may not result in significant cost savings (Gong, 2003). Geographic, psychic and political distances impact both the costs of managing FDI, and the desirability of an expatriate assignment (Rickley & Karim, 2018). To account for these factors, we use the distance between the capital of the host country and Tokyo (Dow & Karunaratna, 2006). The psychic distance index, a formative factor comprising linguistic, religious, industrial development, educational and political distances of the host country from Japan

(Dow & Karunaratna, 2006) using the Mahalanobis distances procedure recommended by Berry, Guillén, and Zhou (2010), and the political constraints index of Kaufmann, Kraay, and Mastruzzi (2008) account for cultural and other institutional distances, respectively. Japanese parent firm’s international experience, measured in aggregate subsidiary-years, is included to account for its association with the declining use of expatriates (Riaz, Rowe, & Beamish, 2014). We also include two dummy variables indicating whether the subsidiary was a joint venture, or an acquisition, respectively.

In our second model, we included controls to account for other known attractors of FDI. From the World Trade Organization, we included per capita GDP and GDP growth to account for overall market attractiveness and economic health of alternate investment locations (Caves, 2007), trade as a percentage of GDP, FDI as a percentage of GDP (Dunning, 1988) and political constraints which mitigate public expropriation risk in a host country (Globerman & Shapiro, 2002; Henisz, 2000). We supplement GDP per capita with unemployment levels, as we were unable to source a direct measure of labor costs with sufficient coverage for our sample. We included inflation rate, measured by changes in the consumer price index, and exchange rates which can impact the timing of investment (Desatnicov & Akiba, 2016; Takagi & Shi, 2011) from the World Bank. Similar to our governance model, we control for psychic and geographic distances. Finally, we include the logarithmic count of prior entries to a country by Japanese parent firms to account for agglomeration (Tan & Meyer, 2011).

### 3.5. Analysis

We use two independent models to test our hypotheses, accounting for our two dependent variables. Hypotheses 1 and 3 were tested using mixed-effects fractional regression. Hypotheses 2 and 4 were tested with discrete choice modelling.

#### 3.5.1. Mixed-effects fractional regression model

Our dependent variable for testing hypotheses 1 and 3 is the Japanese expatriate ratio, taking on values from zero to one, inclusive. These constraints on the value of the dependent variable violate the assumptions of ordinary least square, logistic and beta regression models (Wulff & Villadsen, 2020). Our data consists of repeated observations of subsidiaries, so lack of independence also had to be accounted for. We thus modelled the relationship between expatriate ratio and the predictors using a heteroskedastic probit model, with expatriate ratio following a binomial distribution. This approximation to a linear relationship for a fractional dependent variable is shown to produce consistent estimates, including near extreme values of the dependent variable (Papke & Wooldridge, 1996; 2008). Hence, we estimated the following mixed effects equation, fitted via maximum likelihood:

$$\Pr(y_{it} \neq 0 | x_{it}) = \Phi(x_{it}\beta + v_i) \tag{1}$$

with variance components:

$$x_{it}\beta + v_i + \epsilon_{it}$$

This model predicts the dependent variable, expatriate ratio ( $y$ ) given a vector of controls, SHR index, listed ownership and the interaction of the two ( $X$ ) for  $i$  panels (subsidiaries) and  $t$  years, and  $\Phi$  is the standard normal cumulative distribution function.  $\epsilon_{it}$  are iid Gaussian distributed, with mean zero and variance of 1, independently of the subsidiary random effects,  $v_i$ . This method produces average partial effects which are identified without assumptions about serial correlation between repeated observations (Papke & Wooldridge, 2008).

#### 3.5.2. Discrete choice modelling

Discrete choice modelling is a simulated log-pseudolikelihood method for modelling choices between realistic alternatives, rather than an infinite set of theoretical alternatives (Revelt & Train, 1998). We use a mixed logit model of discrete choice, in which unobserved utility is

decomposed into an independent, identically distributed error term and a random component, allowing us to model both fixed effects of location characteristics, such as SHR, and variance in the utility of those characteristics. In the context of our hypotheses, the impact of shareholder rights index on location attractiveness is allowed to vary from one investment decision to the next, thus avoiding the restrictive assumption of preference homogeneity (Train, 2009). The probability of selecting a country (a) for an investment (i) is integrated over the density function,  $f(\beta)$ :

$$P_{ia} = \int P_{ia}(\beta)f(\beta)d\beta \tag{2}$$

where the logistic probabilities are given as:

$$P_{ia}(\beta) = \frac{e^{x_{ia}\beta_i + w_{ia}\alpha}}{\sum_{a=1}^A e^{x_{ia}\beta_i + w_{ia}\alpha}}$$

$\beta_i$  are random coefficients that vary by subsidiary, and  $x_{ia}$  is a vector of alternative specific variables (i.e. SHR index, interaction of SHR index and listed Japanese parent ownership, and controls).  $\alpha$  is a vector of fixed coefficients for  $w_{ia}$  which is a vector of country-specific control variables. Discrete choice modelling does not rely on the independence of irrelevant alternatives (IIA) assumption (Revelt & Train, 1998; Train, 2009). Hence, there is no assumption of independence of the preference for a location from counterfactuals in the choice set. The integral in (2) has no closed-form solution, and thus is approximated by maximum simulated likelihood using 500 Halton draws, which is sufficient to produce consistent estimators (Hole, 2007).

## 4. Results

### 4.1. Shareholder rights protection (SHR) and Japanese expatriate staffing

Table 1 presents the means, standard deviations, and pairwise correlations (two-tailed) for all variables included in the mixed-effect fractional regression model, used to test hypotheses 1 and 3. The average subsidiary had a ratio of 10% expatriates to total employees, and 47% ownership by parent firms listed on the TSE. 55% of these subsidiaries were joint ventures, while <1% were acquisitions. High correlations are observed between some of the country control variables, such as between GDP per capita, geographic and psychic distances. SHR also has moderate correlation with GDP per capita (0.331), which can be explained by the fact that more developed economies tend to have more developed capital markets.

Table 2 presents the results of the heteroskedastic probit model used to estimate the impact of SHR on Japanese expatriates deployed as a percentage of total subsidiary employees. Model 1 includes all control variables, and the Wald  $\chi^2$  coefficient of 3,854.05 ( $p < 0.001$ ) leads to rejecting the hypothesis that all coefficients of these predictors are simultaneously zero. Model 2 adds SHR protection, while Model 3 adds the interaction between SHR protection and listed Japanese ownership ratio. Individual variance inflation factors were between 1.01 and 3.57, with the mean value being 1.80 for the full model. The variance inflation factors for GDP per capita and geographic distance were 3.57 and 3.03, respectively, and their correlations with other country control variables are high. Thus, caution in interpreting their respective coefficients is warranted.

Hypothesis 1 predicted that Japanese expatriate ratio would decline as SHR in the host country of an investment increased. The coefficient ( $\beta = -0.044$ ,  $p < 0.001$ ) in Model 2 indicates that a 10% increase in SHR results in a reduction in expatriate deployment of 4.4%, supporting H1. Hypothesis 3 predicted that the negative relationship between SHR and expatriate ratio would be strengthened for subsidiaries with a higher share of ownership by Japanese parents listed on the TSE. Again, the coefficient of the interaction between SHR and listed ownership ( $\beta = -0.011$ ,  $p < 0.05$ ) is in keeping with this prediction, and indicates that a

**Table 1**  
Descriptive Statistics and Pairwise Correlations (Expatriate Staffing Sample).

Variable	Mean	s.d.	1	2	3	4	5	6	7	8	9
1. Expatriate ratio	0.099	0.136									
2. GDP per capita (10,000 s)	1.871	1.839	0.282*								
3. Geographic distance (1,000 s)	5.942	3.710	0.226*	0.747*							
4. Psychic distance	0.734	0.328	-0.222*	-0.647*	-0.542*						
5. Political stability	0.439	0.378	0.157*	0.650*	0.758*	-0.662*					
6. Int'l experience	3.216	0.644	-0.118*	0.059*	0.082*	-0.015*	0.071*				
7. Joint venture	0.549	0.498	-0.282*	-0.214*	-0.118*	0.117*	-0.069*	0.085*			
8. Acquisition	0.004	0.060	-0.024*	0.064*	0.052*	-0.042*	0.047*	0.014*	-0.010*		
9. Listed ownership	0.472	0.437	0.182*	0.086*	0.035*	-0.079*	0.027*	0.089*	-0.497*	0.003	
10. SHR index	5.822	1.355	0.066*	0.331*	0.062*	-0.085*	0.072*	0.074*	-0.159*	0.024*	0.061*

Notes: n = 182,169; countries = 55; subsidiaries = 23,616; and \* denotes significance at 5%.

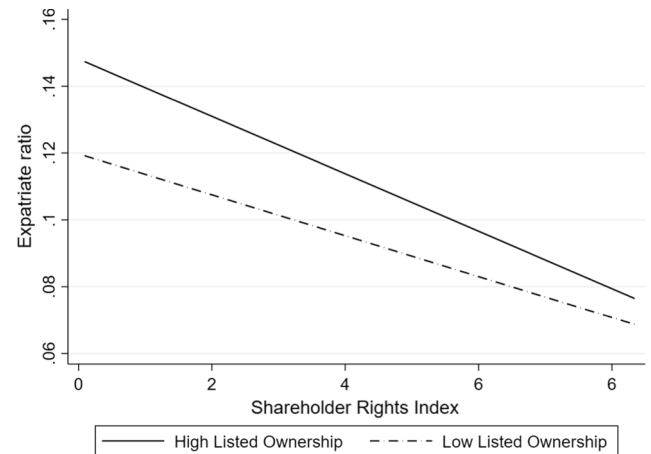
**Table 2**  
Shareholder Rights Protection, Equity Ownership Level and Expatriate Deployment Ratio.

Variables	Model 1	Model 2	Model 3
GDP pc (10,000 s)	-0.013 (0.004) ***	0.006 (0.004)	0.006 (0.004)
Geographic distance (1,000 s)	0.035 (0.002) ***	0.030 (0.002) ***	0.030 (0.002) ***
Psychic distance	-0.371 (0.018) ***	-0.345 (0.018) ***	-0.345 (0.018) ***
Political stability	-0.155 (0.015) ***	-0.165 (0.015) ***	-0.165 (0.015) ***
Parent int'l experience	-0.213 (0.005) ***	-0.193 (0.005) ***	-0.194 (0.005) ***
Entry mode:			
Joint venture	-0.095 (0.008) ***	-0.106 (0.008) ***	-0.106 (0.008) ***
Acquisition	-0.314 (0.038) ***	-0.309 (0.039) ***	-0.309 (0.039) ***
Listed ownership	0.101 (0.010) ***	0.095 (0.010) ***	0.095 (0.010) ***
SHR index	..	-0.044 (0.003) ***	-0.043 (0.003) ***
Listed ownership × SHR index	..	..	-0.011 (0.005) *
Constant	-1.290 (0.005) ***	-1.288 (0.005) ***	-1.288 (0.005) ***
Wald chi <sup>2</sup>	3,854.05 (0.000)***	4,072.58 (0.000)***	4,072.96 (0.000)***
Number of observations	182,169	182,169	182,169
Number of subsidiaries	23,616	23,616	23,616
Years (min – max)	1–24	1–24	1–24
Year (average)	7.7	7.7	7.7
Number of countries	55	55	55

Notes: Robust standard errors are in parentheses; all tests are two-tailed; \*, \*\*, and \*\*\* denote significance levels of 5%, 1%, and 0.1%, respectively. Model 3 individual VIF <= 3.57, mean VIF = 1.80.

10% increase in listed ownership share results in a reduction in the ratio of expatriate to total employees of 1.1%. Fig. 2 plots the effect of the interaction between SHR and Japanese expatriate ratio for two levels of listed ownership (one standard deviation below and above the mean, respectively). Control variables are held at their means to generate these plots.

Fig. 2 shows that the relationship between SHR and Japanese expatriate ratios for both values of listed ownership is negative, but that the slope is steeper for high listed ownership than for low listed ownership, thus providing additional evidence in support of H3. Note that the marginal predicted probabilities are a non-linear function of the covariates in the generalized estimating equation, as the marginal predicted value is not only a function of these covariates, but also the starting value of the predictor variable, in this case SHR. However, the plot depicted in Fig. 2 suggests very little curvature, such that a linear interpretation is practically sufficient. In summary, the results of models 2 and 3 support the hypothesized relationships between SHR protection



**Fig. 2.** SHR index and Japanese expatriate deployment ratio for subsidiaries with low vs. high listed Japanese parent firm ownership (hypothesis 3).

and Japanese expatriate ratio (Hypothesis 1) and the moderating impact of listed ownership, which strengthens the aforementioned relationship (Hypothesis 3). However, as noted below, robustness checks found that the coefficient for the interaction of SHR and listed ownership share is not significant across different time periods, and thus a more conservative interpretation is that Hypothesis 3 received qualified support.

4.2. Shareholder rights protection (SHR) and location attractiveness

Table 3 presents the means, standard deviations and pairwise correlations (two-tailed) for all variables included in mixed-effects discrete choice model, and Table 4 presents the results. Standard deviations of estimates modelled as random are shown in Table 4 in italics, immediately following the mean of the coefficient estimate. We do not include the mean and standard deviation for location choice because it summarizes both the actual subsidiary location and a wide range of counterfactual locations. The average location considered for investment has a GDP per capita of about \$17,000, 3.9% GDP growth, and FDI and trade accounted for roughly 43% and 72% of GDP, respectively, though integration within the global economy varied widely amongst countries included in the sample. Similar to the governance models, the highest correlations occurred between country control variables, especially GDP per capita, GDP growth, geographic and psychic distances.

Model 1 includes all control variables, but excludes the SHR index. Model 2 includes the effect of shareholder rights, while Model 3 adds the interaction between SHR protection and ownership percentage by listed Japanese parent firms. The individual variance inflation factors for the discrete choice models were all below 3, with the highest average (Model 3) being 1.82. The coefficients can be interpreted according to the formula  $100 \times \Phi(-b_k / s_k)$  where  $b_k$  and  $s_k$  are the mean and standard deviation of the  $k^{\text{th}}$  coefficient and  $\Phi$  is the standard normal cumulative

**Table 3**  
Descriptive Statistics and Pairwise Correlations (Subsidiary Location Choice Sample).

Variable	Mean	s.d.	1	2	3	4	5	6	7	8	9
1. Location	–	–									
2. GDP pc (10,000 s)	1.711	1.936	–0.012*								
3. GDP growth	3.885	3.472	0.104*	–0.179*							
4. Log exchange rate	2.580	2.916	0.003*	0.157*	–0.113*						
5. Inflation	7.194	4.972	–0.070*	–0.129*	–0.303*	0.055*					
6. Unemployment	33.126	291.923	–0.012*	–0.066*	–0.120*	0.201*	–0.003*				
7. FDI stock	42.843	200.573	–0.009*	0.108*	–0.028*	0.074*	–0.018*	–0.018*			
8. Trade ratio	72.761	54.823	0.014*	0.176*	0.098*	0.011*	–0.107*	–0.070*	0.084*		
9. Geog. distance (1000 s)	9.181	3.896	–0.123*	0.022*	–0.314*	0.249*	0.352*	0.132*	0.052*	–0.225*	
10. Psychic distance	0.763	0.298	–0.001	–0.599*	0.111*	–0.050*	0.041*	0.041*	–0.120*	–0.054*	0.049*
11. Prior entries	0.142	0.526	0.148*	0.049*	0.073*	0.035*	–0.065*	–0.010*	0.002*	0.038*	–0.084*
12. Political stability	0.337	0.201	–0.073*	0.315*	–0.251*	0.025*	0.120*	–0.009*	–0.019*	–0.120*	0.258*
13. SHR index	4.696	1.653	0.056*	0.152*	0.024*	0.150*	0.155*	–0.016*	0.125*	0.154*	–0.028*
14. Listed ownership	0.572	0.415	–0.000	–0.006*	0.011*	–0.015*	–0.005*	–0.010*	0.018*	0.013*	–0.000

Variable	10	11	12	13
11. Prior entries	–0.090*			
12. Political stability	–0.382*	–0.025*		
13. Shareholder rights	–0.178*	0.103*	–0.042*	
14. Listed ownership	0.017*	0.048*	0.001	0.039*

Notes:  $n = 1,363,990$ ; countries = 64; subsidiaries = 25,518; and \* denotes significance at 5%. Mean and standard deviation of 'Location' depends on the choice set used in the analysis and hence are omitted from the descriptive statistics.

distribution (Hole, 2007). The coefficients in Model 2 indicate that in 80.1% of subsidiary location choices, MNEs preferred locations with higher SHR, and also that MNEs prefer locations with higher GDP per capita, GDP growth, exchange rates, psychic distance, and a larger number of prior entries by Japanese firms. In contrast, MNEs prefer locations with lower inflation, unemployment, geographic distance, and political stability.

The coefficients for FDI stock, trade ratio, and inflation are quite small, and so their signs should not be interpreted without consideration of the diminished effect size. Hypothesis 2 predicted a positive relationship between SHR protection and the probability that Japanese MNEs will choose a location to make an investment. In Model 2, the positive coefficient ( $\beta = 0.242, p < 0.001$ ) associated with SHR protection supports Hypothesis 2.

Model 3 adds the interaction of SHR and ownership share of listed Japanese parent firms and the size of the coefficient for SHR declines ( $\beta = 0.172$ ). For listed firms, the preference for higher SHR protection was incrementally higher ( $\beta = 0.132$ ) compared to unlisted firms, but the overall effect must consider the magnitude of the main effect of SHR protection. Therefore, we use a user-defined Stata function (Hole, 2007) to compute the predicted probabilities of locating a subsidiary in a specific country, at varying levels of SHR protection and listed ownership share, while holding all other covariates at their sample means. Fig. 3 plots the interaction between SHR and the predicted probability of establishing a subsidiary, where low and high listed ownership are one standard deviation below and above the mean, respectively. As depicted in Fig. 3, the relationship between SHR and FDI location attractiveness is positive for both values of listed ownership, but the slope is steeper for high listed ownership than for low listed ownership, consistent with H4.

4.3. Robustness tests

We modelled effects as random when they resulted in significant preference heterogeneity, and modeled all others as fixed. We also ran our models using only fixed effects, finding similar support for our hypotheses, with a much larger observed estimate for the effect of SHR on FDI location attractiveness. Hence, the result of this study is more conservative than would be obtained using a purely fixed effects model. We also conducted tests of subsamples and with the inclusion of dummy variables to account for different sectors (i.e. primary, manufacturing, retail, wholesale, and services), finding only differences that could be explained by the resulting change in the sample size and power. Since

our data spans a significant period of time, we used subsample testing to investigate possible differences over time. We used the Asian financial crisis and 2008 financial crisis to define the subsamples, observing a small drop in the number of investments made in 1997–98 and in 2007–08. In the case of expatriate deployment, H1 continues to receive strong support across all subsamples. The coefficient for the interaction of SHR and listed ownership share (H3) was not significant in two of the subsamples (1998–2007 and 2008–2013). While this can be accounted for by the smaller sample sizes, caution should be used in interpreting this effect, as it may be small. For location choice, the results for both the main effect of SHR (H2) and its interaction with listed ownership share (H4) received consistent support across all time periods. The results of these robustness checks are available from the authors, upon request.

5. Discussion

5.1. Contributions to theory

We found that SHR attracts FDI due to its mimetic and normative influences, rather than the coercive pressures normally associated with state policy (Globerman & Shapiro, 2003). We thus extend research on institutional distance (Kostova et al., 2020) by examining how SHR protection can influence MNEs via informal (mimetic and normative) vs. formal (coercive) pressures (Scott, 2008). Research on the unintentional consequences of policy distance has led to other counterintuitive findings, such as positive association between institutional distance and the quality of the HQ-subsidiary relationships (Li, Jiang, & Shen, 2016). Research on unintended effects is less prevalent than on the intended effects of institutional reform (Cuervo-Cazurra, Gaur, & Singh, 2019). We thus contribute to research on the interaction between the institutional fields of MNE home and host countries (Saka-Helmhout et al., 2016). Moreover, our paper extends previous studies on MNEs' FDI decision making. Using UK firms' investment within continental Europe, Lskavyan and Spatareanu (2011) found that weak shareholder protection in the host countries is less attractive to FDI, but also argued that it could be influenced by parent firms' ownership concentration. Our paper reaffirms the relationship between high SHR and the location attractiveness based on more host country locations. Furthermore, it illustrates that exchange-listed MNE ownership strengthen the attractiveness of high SHR countries.

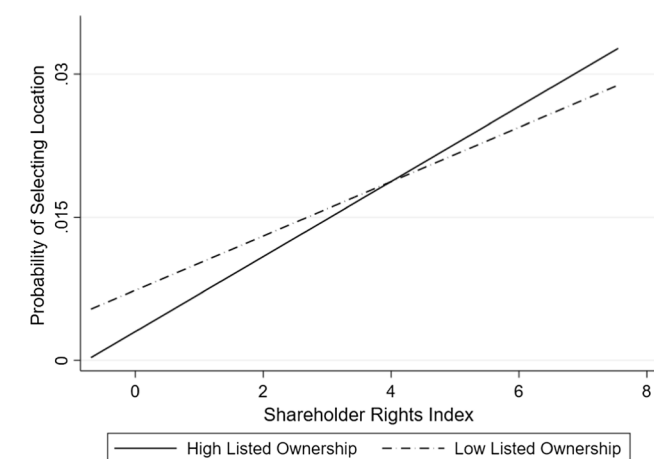
We also contribute to distinguishing public from private expropriation risk in international business decisions (Sartor & Beamish, 2019).



**Table 4**  
Japanese FDI Location Choice and the Effect of Host Country Shareholder Rights Protection.

Variables	Model 1	Model 2	Model 3
GDP pc (10,000 s)	0.099 (0.005) ***	0.076 (0.006) ***	0.076 (0.006) ***
GDP growth	0.058 (0.003) ***	0.052 (0.003) ***	0.052 (0.003) ***
Log exchange rate	0.066 (0.005) ***	0.061 (0.005) ***	0.061 (0.005) ***
Inflation	-0.024 (0.004)***	-0.046 (0.004) ***	-0.047 (0.004)***
Unemployment	-0.002 (0.000)***	-0.001 (0.000) ***	-0.001 (0.000)***
FDI stock	-0.002 (0.000)***	-0.001 (0.000) ***	-0.001 (0.000)***
Trade ratio (mean)	-0.001 (0.001)***	-0.002 (0.000) ***	-0.001 (0.000)***
Standard deviation of coefficient	0.006 (0.000) ***	0.004 (0.000) ***	0.004 (0.000) ***
Geog. distance (1,000 s, mean of coefficient)	-0.282 (0.008)***	-0.272 (0.007) ***	-0.272 (0.007)***
Standard deviation of coefficient	0.200 (0.007) ***	0.189 (0.007) ***	0.189 (0.007) ***
Psychic distance	0.429 (0.034) ***	0.669 (0.036) ***	0.673 (0.036) ***
Prior entries (mean of coefficient)	2.243 (0.137) ***	2.100 (0.126) ***	2.095 (0.126) ***
Standard deviation of coefficient	1.563 (0.172) ***	1.432 (0.161) ***	1.424 (0.160) ***
Political stability (mean of coefficient)	0.271 (0.060) ***	0.322 (0.053) ***	0.328 (0.054) ***
SHR index (mean of coefficient)	..	0.242 (0.009) ***	0.172 (0.013) ***
Standard deviation of coefficient	..	0.302 (0.021) ***	0.177 (0.044) ***
SHR × Listed ownership	..	..	0.132 (0.015) ***
Standard deviation of coefficient	..	..	0.378 (0.030) ***
Log simulated-pseudolikelihood	-75,419.546	-74,679.478	-74,613.357
Number of observations	1,363,990	1,363,990	1,363,990
Number of countries (mean)	34–64 (53.452)	34–64 (53.452)	34–64 (53.452)
Number of parent firms	5,673	5,673	5,673
Number of subsidiaries	25,518	25,518	25,518

Notes: Standard errors (in parentheses) are clustered by Japanese parent firm; \*, \*\*, and \*\*\* denote significance levels of 5%, 1%, and 0.1%, respectively; Model 3 individual VIF <= 1.82, mean VIF = 1.32.



**Fig. 3.** SHR index and location attractiveness for subsidiaries with low vs. high listed Japanese parent firm ownership (hypothesis 4).

Substantial research examines the role of subsidiary managers as agents of the MNE headquarters (Filatotchev & Wright, 2011; Meyer et al., 2020), with many results indicating that expatriates are preferred. Our results demonstrate that MNEs will deploy fewer expatriates when SHR protection is higher and a positive relationship between SHR protection and location attractiveness for FDI, despite the fact that Japanese MNEs have less propensity to employ local managers than other MNEs (Beamish & Inkpen, 1998). Our argument was based on the normative and cognitive pressures arising from the education and experience of local employees, respectively, which create conformance to management practices of higher SHR countries. Nonetheless, our findings should be extended with multilevel examinations incorporating specific qualities of expatriates, such as cultural intelligence (Meyer et al., 2020), in order to understand how MNE staffing inclinations align with subsidiary performance.

Finally, our empirical findings extend the generalizability of the relationship between SHR and FDI attractiveness by examining discrete investment decisions rather than the aggregate value of FDI flows (Baukaran & Lupton, 2020; Wang et al., 2012). Our study uses a direct measure of SHR protection (Guillén & Capron, 2016), which is both conceptually and empirically separate from property rights protection, and the legal systems that produced them. While on the surface our finding appears to contradict that of Wang et al. (2012), who find that an increase in shareholder rights protection in the US could partially explain a reduced inflow of Japanese FDI, our sample provides a range of host country choices. To date, the SHR attractiveness relationship has been confirmed for MNEs from Europe (Lskavyan & Spatareanu, 2011), United States (Baukaran & Lupton, 2020; Globerman & Shapiro, 2003) and we extend this to FDI from Japan. This represents the triad of major investing regions of the world, but FDI from emerging economies is surging (Cieřlik & Tran, 2019; Cui & Jiang, 2009), thus increasing the diversity of home country institutional environments that need to be considered. When considering institutional distance, direction matters (Konara & Shirodkar, 2018), and so future research should consider FDI from countries that place lower priority on SHR.

5.2. Implications for policy and practice

Our findings have implications for policy makers trying to avoid FDI’s negative influence on home country employment, referred to as ‘brain drain’ or ‘hollowing out’ effects (Blomstrom, Fors, & Lipsey, 1997; Huijie, 2018; Lipsey, 1995). While not as frequently discussed, expatriate staffing can also represent a form of industrial hollowing out, with the consequence that less managerial experience is accumulated within the local population. Policy makers can help to mitigate this effect by instituting stronger legal frameworks for SHR protection, thereby encouraging the MNE to hire locally.

Our finding that Japanese MNEs choose higher SHR countries for investment also has implications for managers making FDI decisions. While expatriate staffing can lead to superior subsidiary financial performance where increasing subsidiary knowledge creation capability is desirable (Kawai & Chung, 2019), on average, employing local managers is less costly than deploying expatriates, and the anticipated costs of monitoring will also be reduced when SHR protections are high. Our findings suggest that MNEs invest in host countries when SHR is congruent with home country institutions. This not only helps investing countries alleviate their ‘brain drain’ concern, but can also save the MNE the substantial costs of deploying expatriates.

5.3. Limitations and future research

Our study focuses only on the outward FDI of Japanese MNEs, and thus only one direction of institutional distance (Berry et al., 2010; Zaheer et al., 2012). Future studies should examine the impact of SHR protection on FDI decisions made by MNEs from low SHR protection countries, as these may be unaffected or repelled by high SHR

protection. Future research should also continue to examine specific institutional factors, especially in cases where institutional logics may be contradictory, as in the emerging policy implementation of the United Nations' Sustainable Development Goals. Also, research on subsidiary shareholder-stakeholder conflicts warrants future examination as it is outside the scope of this study.

## 6. Conclusions

We found that SHR protection is an attractive to FDI of Japanese MNEs, especially those listed on the TSE. Congruent with organizational institutionalism, we reasoned that it is more efficient for MNEs from home countries with strong SHR protection to locate in countries with similar environments, not because they offer legal protection to shareholders in the home country, but because the socialization of local managers and employees reduces private expropriation risk. In arguing that informal institutional pressures are the mechanism at play, we demonstrate the value of investigating the unintentional impact of regulatory changes. Specifically, stronger SHR protection is more likely to attract FDI, other things equal, and those investments will involve a smaller number of expatriates, thus creating more opportunities for developing local management talent. This latter finding also provides potential benefits for MNEs to mitigate the expenses and risk associated with expatriate deployment.

## CRedit authorship contribution statement

**Nathaniel C. Lupton:** Writing – review & editing, Writing – original draft, Visualization, Validation, Software, Project administration, Methodology, Investigation, Formal analysis, Data curation, Conceptualization. **Vishaal Baulkaran:** Writing – review & editing, Writing – original draft. **Yeonji No:** Writing – review & editing, Writing – original draft.

## Declaration of Competing Interest

The authors declare that they have no known competing financial interests or personal relationships that could have appeared to influence the work reported in this paper.

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