DO REGIONS MATTER? AN INTEGRATED INSTITUTIONAL AND SEMIGLOBALIZATION PERSPECTIVE ON THE INTERNATIONALIZATION OF MNEs

JEAN-LUC ARREGLE,1* TOYAH L. MILLER,2 MICHAEL A. HITT,3 and PAUL W. BEAMISH4

1 EM Lyon Business School, Ecully, France
2 Kelley School of Business, Indiana University, Bloomington, Indiana, U.S.A.
3 Mays Business School, Texas A&M University, College Station, Texas, U.S.A.
4 Richard Ivey School of Business, University of Western Ontario, London, Ontario, Canada

Traditional research suggests a relationship between country-level institutions and the location choices of MNEs. However, more recent theory suggests MNEs also focus on regions (semiglobalization). Therefore, this study examines institutional effects in the context of semiglobalization by considering the influences of three formal institutions (i.e., regulatory control, political democracy, capital investments) of countries and geographic regions on MNEs’ location choices of internationalization. We use a sample of Japanese MNEs operating in 45 countries within eight regions. The results show that their degree of internationalization into a country is influenced by both country and regional institutional environments. Additionally, a semiglobalization perspective provides better explanatory power than does the country-level perspective. These results present a new perspective on how MNEs consider institutional environments in their international strategy.

INTRODUCTION

The decision to expand operations into foreign markets, or internationalize, is one of the most important strategic decisions made by multinational enterprises (MNEs) (Goerzen and Beamish, 2003; Hitt, Hoskisson, and Kim, 1997). As a result, factors that influence how much and where to internationalize have attracted much attention in the scholarly literature using a number of different theoretical perspectives. One perspective acknowledges the importance of institutions. Here, scholars have focused on country-level influences whereby location-specific institutional factors affect the MNE’s ability to exploit its resources in host countries and thereby influence its internationalization decisions in these countries (e.g., Chan, Isobe, and Makino, 2008; Gaur, Delios, and Singh, 2007; Meyer et al., 2009). Recently, a second stream of research has focused on MNEs’ international strategy of semiglobalization. The ‘semiglobalization’ perspective emphasizes the importance of regions in MNEs’ international strategy as their regional coordination helps them to maintain local responsiveness and exploit region-bound firm-specific advantages (Ghemawat, 2003, 2007; Rugman and Verbeke, 2004, 2005). These two streams of research have developed independently,

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*Correspondence to: Jean-Luc Arregle, EM Lyon Business School, 23 avenue Guy de Collongue, 69134 Ecully Cedex, France. E-mail: arregle@em-lyon.com

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leaving gaps in our understanding of whether and how regions matter in MNEs’ international strategy. For instance, there is a need for a greater understanding of how formal institutions influence internationalization decisions at the country and regional levels (Chan et al., 2008).

Accordingly, in this study we provide a multilevel rationale for MNE decisions about where and how much to internationalize (i.e., an MNE’s degree of internationalization into a host country) by investigating the dual effects of formal institutions (North, 1990; Williamson, 2000) at the country and region levels. We examine the effects of three formal institutions (i.e., regulatory control, political democracy, capital investments) in the context of semiglobalization. These perspectives suggest that MNEs consider institutional environments in their decisions about where and how much to internationalize at two critical levels: selecting attractive regions and selecting attractive countries within regions. As mentioned, it is known that institutions affect the attractiveness of FDI destinations. However, we develop and test a different perspective. Countries are attractive not only because of their institutions but also because they serve as platforms for entry into their regions, enabling regional arbitrage, creating real options for regional expansion, and increasing the value of pre-existing regional investments.1 Hence, the institutions of a region in which a country is located are an important criterion for an MNE’s degree of internationalization into a country. We test these models by applying a multilevel methodology explaining the propensities of Japanese MNEs to internationalize into 45 countries located in eight geographic regions.

This study contributes in several ways to our knowledge of strategic decisions regarding foreign direct investments (FDIs), the effects of institutional environments, and a semiglobalization strategy. First, our study provides additional support for the prior arguments on the importance of regionalization (or semiglobalization). Our investigation confirms that an MNE’s prior internationalization into a region has an effect on its future decisions to internationalize into a country, validating a semiglobalization approach. Second, we separate the dual effect of three formal institutions on MNEs’ choices of internationalization at the region and country levels, showing the relevance of a ‘semiglobalized’ institutional perspective. Third, we identify the effects on internationalization decisions of the institutional environment in geographic regions and the effects of a country’s institutional profile relative to other countries’ profiles in the same region. Although research exists on specific regions and on effects of particular institutions (e.g., Oxelheim and Ghauri, 2004; Schiavo, 2007; Seyf, 2001), little is known about how an MNE considers the attractiveness of a region and of countries within it. Finally, we further compare the traditional country-level institutional approach with the region- and country-level semiglobalized model to understand which provides a better understanding of the institutional environment’s influence on MNEs’ foreign market investment decisions. Thus, we complement previous studies with a more inclusive view, resulting in a new and more systematic understanding of the effects of the institutional environment on internationalization decisions.

THEORETICAL DEVELOPMENT

Current theoretical and empirical work on MNE internationalization emphasizes the systematic ownership and location advantages of FDI and identifies the role of institutions in motivating foreign investments into a country (e.g., Delios and Henisz, 2003; Globerman and Shapiro, 2003). The institutional environment consists of those structures that form the basis for a society and constrain behavior within it (North, 1991). In addition, new institutional economists have emphasized the important role that formal institutions play in providing stability, minimizing market failures, reducing uncertainty, and alleviating information complexity in economic exchanges (North, 1990; Williamson, 2000). Thus, it is clear that institutions matter, particularly the formal institutional structures that, through written laws, regulations, policies, and their enforcement measures, prescribe the actions and behaviors of people, systems, and organizations.

The three formal institutional ‘pillars’

North (1990) argued that the constraints of formal institutions occur through political, regulatory, and economic structures because of their strong and visible impact; as such, they are likely to
influence localization decisions (Holmes et al., 2013). The regulatory environment provides oversight and direction for the conduct of organizations. As an institution of potential coercive force, the regulatory environment influences firm actions through rule-setting, monitoring, and sanctions, thereby reducing uncertainty for the collective (North, 1991). Early institutional economists (e.g., Coase, 1959) focused on the power of regulations to create and enforce property rights protections; these regulations were believed to aid market transactions under the assumption that ‘government steps aside’ and releases control to allow free markets after this role is fulfilled (Williamson, 2000: 598). Thus, many attributes of the regulatory environment, such as the level of enforcement or openness of law, might also facilitate market transactions by reducing uncertainty (Globerman and Shapiro, 2003). However, Bardhan (1989) suggests that extensive governmental control or interference in business is often perceived as a hindrance to the conduct of business and may even go beyond serving its beneficiaries. For example, research has found that government regulations frequently increase the perceived transactions costs of doing business abroad and also lead to sacrifices in efficiency (Brouthers, 2002; Yiu and Makino, 2002). Thus, regulatory control, that is, greater government involvement in setting rules and standards that prescribe and constrain the behavior of organizations in commerce often also imposes direct or indirect costs on the firm (i.e., the formal rules and laws that monitor and direct the conduct of firms).

Second, as an institution, political democracy establishes the level of checks and balances in government and reflects an ideology of how people and entities in society (e.g., organizations) should be governed (Gaur et al., 2007). It affects the MNE operations as political regimes can create significant uncertainty and potential costs for them. Political democracy reflects the discretion of government over its citizenry and is marked by voting rights and freedom of speech, assembly, and media. Thus, while the regulatory environment focuses on the application of laws and rules in commerce, the political environment prescribes how laws and rules are created, defining the society’s level of human and political rights for participation in rule-setting and freedom of expression2 (Adam and Filippaios, 2007). As separate constructs, one captures the level of representation, participation, and freedoms available to people in voicing opinions and influencing outcomes; whereas, the other focuses on the degree of parameters for commerce resulting from legislation.

Finally, strong economic institutions serve as a formal constraint that reduces uncertainty and information asymmetries between borrowers and lenders in transactions and establishes rules in the market economy (Hodgson, 1988; North, 1990). These institutions are location specific and can facilitate as well as constrain market behaviors (Zukin and DiMaggio, 1990). Economic institutions influence the availability of financial resources and potential consumption, production, and cost of living in the country, and thus they have a strong impact on FDIs (Brouthers and Brouthers, 2000). These economic institutions are evident in a country’s monetary and fiscal policies (Beck, Levine, and Loayza, 2000; Lucas, 2003). Given their influence on purchasing power and investments made in labor, technology transfer, and production (Romer, 1994), a country’s capital investments, or the commitment of capital or money to purchase assets, promote an economy’s strength and liquidity, thereby increasing a location’s attractiveness for MNE investment and serving as a proxy for the strength of economic institutions (Tirole, 2003).

The role of regions in semiglobalization

A focus on the globalization of international firms that solely considers effects at the level of the host country (including their institutions) may not fully or accurately represent MNEs’ strategic practices (Ghemawat, 2003; Rugman and Verbeke, 2004). In response, a semiglobalization approach suggests that a firm’s foreign investments follow patterns exhibiting regional aggregation and arbitrage logic to cope with the opposing pressures of globalization (i.e., integration) and local markets (i.e., localization) (Arregle, Beamish, and Hebert, 2009). Semiglobalization involves partial cross-border integration whereby barriers

2 However, we note that political structures can affect changes in regulations. For example, differing political views allowed by political democracies may slow regulatory changes (Becker, 1985; Li, Qiang, and Xu, 2005).
to market integration are high but not high enough to insulate countries completely from each other. These situations cannot be fully understood through purely country-level analyses but require an evaluation of operations across multiple locations (e.g., within a region) that are distinct from but not entirely independent of each other (Ghemawat, 2003). Therefore, the region composed of geographically proximate countries becomes an important level of analysis when examining MNEs’ internationalization and institutional influences (Arregle et al., 2009; Ghemawat, 2003).

**Semiglobalization mechanisms and prior regional internationalization**

The semiglobalized perspective suggests that firms often seek to expand by exploiting their prior internationalization in regions and specific countries in those regions. Two key mechanisms help MNEs engage in this semiglobalization behavior: the redeployment of region-bound firm-specific advantages and organizational learning.

**Region-bound firm-specific advantages**

The MNE’s geographic scope is a critical dimension of its international strategy and is determined by the ability to integrate firm-specific advantages (FSAs) with country-specific advantages (CSAs). As a result, ‘each foreign location requires location-specific linking investments to meld existing FSAs with CSAs’ (Rugman and Verbeke, 2005: 13). Asset specificity occurs within firms as they make these country-specific investments, imposing a cost and potentially limiting their redeployability. Because a particular resource may have a range of potential services (Mahoney and Pandian, 1992; Teece, 1982), its fungibility, or ‘the extent to which resources can be deployed for alternative uses at low cost,’ is important (Sapienza et al., 2006: 924). Therefore, because internationalization is fraught with uncertainty, fungibility is important for MNEs as it provides flexibility and discretion in executing strategies and contributes to survival and growth while buffering costs (Sapienza et al., 2006).

MNEs can enhance redeployability potential by developing region-bound FSAs (RFSAs) as they can be exploited successfully by a firm throughout a region rather than being restricted to one country. Thus, firms are able to reap benefits from these regional fungible capabilities when they have expanded into countries within that region. They exist when the firm is able to integrate its foreign subsidiaries regionally while maintaining responsiveness at the country level. Therefore, RFSAs can be exploited successfully by a firm across a region through low-cost linking investments (i.e., low transaction costs) due to the relative geographic proximity of these countries and their corresponding CSAs (Rugman and Verbeke, 2005). Generally, replicating and exploiting fungible resources in foreign countries can be challenging because of their intangibility and the need to develop specific approaches to deal with the idiosyncrasies and characteristics of foreign markets (Kumar, 2009). Such processes emphasize the importance of discovering the critical traits of these markets through organizational learning.

**Organizational learning and strategic options**

Acquiring market- and network-specific experiential knowledge is time-consuming yet critical to internationalization success for an MNE because it must overcome its liability of foreignness or outsidership (Johanson and Vahlne, 1977, 2009). Such crucial knowledge can be gained from experience in current international operations. The larger the psychic distance (i.e., ‘factors that make it difficult to understand foreign environments,’ [Johanson and Vahlne, 2009: 1412]) between markets, the more difficult it is for MNEs to develop such knowledge. Because of absorptive capacity (Cohen and Levinthal, 1990), a firm’s knowledge development is cumulative and necessitates a certain level of proximity between old and new competences, resulting in the need for some continuity. Both psychic distance and absorptive capacity result in time compression diseconomies (Dierickx and Cool, 1989; Vermeulen and Barkema, 2002) and in limited path dependence for MNEs’ international expansion. These organizational learning mechanisms explain a sequential approach to international entry as MNEs approach foreign

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3 Johanson and Vahlne (2009) developed this concept of liability considering that MNEs need to enter and develop a relevant position in a network of relationships and not focus only on a specific country.
entry with learning gained from past entry experience, gradually accumulating capabilities in relatively proximate countries and taking the best opportunities that emerge (Chang, 1995).

Prior internationalization into a region also helps MNEs in this learning process because geographic agglomeration can facilitate flows of knowledge within a firm. There are spatial aspects of knowledge, and flows of information are spatially constrained (Buckley and Ghauri, 2004; Sorenson and Baum, 2003). Geographic proximity facilitates the transmission of knowledge and organizational practices within the organization (e.g., Chang and Park, 2005; Strang, 2003). Hence, the MNE’s proximally close foreign subsidiaries can more easily share knowledge and/or organizational routines. Moreover, prior internationalization within a region can help to overcome the liability of outsidership, which is not necessarily limited to the country level but can also occur at the region level (Collinson and Rugman, 2008; Johanson and Vahlne, 2009). Due to the nature of business networks, which increasingly have a regional dimension (Buckley and Ghauri, 2004), a first FDI in a region helps the MNE to reduce this liability for its next FDIs in the same region. Finally, the similarities existing among proximate countries within a region, which result in lower psychic distances among them, allow the MNE to accumulate knowledge and to learn from its initial entries in this region. This incremental regional learning reduces the MNE’s FDI expansion costs in a region and minimizes problems of absorptive capacity or time compression diseconomies in the learning of new capabilities. The result is a region-level sequential entry approach: investing in a country allows the MNE to create a ‘real option’ to expand in the future into other countries (Kogut, 1983; Kogut and Kulatilaka, 1994) within the same attractive region. Hence, after the MNE has established an FDI in a country within a region, it can develop RFSAs for that region providing a platform for future expansion into other countries within that region. Applying these two mechanisms, we propose the following hypothesis on MNEs’ prior internationalization into a region:

**Hypothesis 1:** The propensity of MNEs to internationalize into a country is positively related to their prior level of internationalization into this country’s region.

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**Semiglobalization, institutional effects, and internationalization decisions**

While a firm may be more likely to expand into a country due to its prior experience within a region, such as the European Union or NAFTA, there are many choices as to which country within each region is the most attractive, and these are highly influenced by the institutional characteristics of the region and countries within it (Kreinin and Plummer, 2008; Oxelheim and Ghauri, 2004). Each geographic region can be described by the general (i.e., average) characteristics of the institutional environments of the countries within it. MNEs carefully consider the general institutional environment of a region in making location decisions because RFSAs are constrained to a specific geographic region, which establishes the boundaries for the future FDI opportunities that can be exploited. Hence, the institutional environments of countries in the region will collectively limit or increase the MNE’s internationalization into a country located in that region.

As a result of possessing RFSAs, MNEs can make arbitrage decisions among countries in the same region. To do so, they compare the relative characteristics of each country to choose the most attractive environments in which to locate their subsidiaries (e.g., Chung, Lu, and Beamish, 2008; Ghemawat, 2003). They exploit intra-regional differences and try to benefit from these variations. Thus, a firm can choose to invest in a country based on the potential host country’s institutional environment relative to the other countries in the same region, or a country’s ‘region-relative’ institutional environment. This variable reflects the variations and indicates the position of a country relative to the general tendency in its region. If a country has a better (worse) region-relative institutional profile, it will attract more (less) MNEs’ investments relative to these other countries in the region.

These arguments suggest that in internationalization decisions, MNEs also focus on a country’s institutional environment in comparison to other countries in the same region. Thus, we next examine the influence of regulatory, political, and economic institutions on localization decisions at the region and country levels.
Regulatory institutional environment

MNEs must conform to regulatory requirements in the host country or region and the cognitive and normative pressures that underlie them (Scott, 1995; Yiu and Makino, 2002). The adoption of organizational practices and compliance by subsidiaries imposes economic costs for implementation as well as additional risks because of the complex challenges involved in navigating rules and regulations (Eden and Miller, 2004; Tirole, 2003). However, when not burdensome, the enforcement of regulations and protections can also provide support for some business activities (Coase, 1959). For example, the development of a legal system, the openness and transparency of regulations, and regulatory enforcement (reducing uncertainty) all positively influence FDI (Bevan, Estrin, and Meyer, 2004; Globerman and Shapiro, 2003; La Porta et al., 1998; Rammal and Zurbruegg, 2006). Yet, government often goes beyond providing necessary protections to undergird transactions by establishing tariffs on trade in order to control such areas as market entry or expansion. In this study, we investigate a related facet of the regulatory environment, namely, the extensiveness of government control of (or interference into) commercial activity. High levels of this type of regulatory control represents a negative cost of doing business that may outweigh its related benefits.

In contrast to the freedom of an open trade environment favored by most multinationals (Globerman and Shapiro, 2003), when regulatory control increases beyond a threshold that facilitates business, it results in additional management challenges, difficult-to-predict violations, high costs, and even barriers to reaching agreements with local partners and governments. High levels of regulation increase government control over organizations, threatening their autonomy and thereby reducing incentives for MNEs to enter that country’s markets (Brouthers and Bamossy, 1997; Kaufmann, Kraay, and Zoido-Lobaton, 1999). Firms must accept the costs of conforming to these local regulations and learn the regulatory requirements and policies of the new setting if they are to survive within it (Eden and Miller, 2004; Levine and Renelt, 1992). These economic costs often entail tariffs, quotas, trade barriers, entry and license fees, and costs of protecting intellectual and property rights, all of which favor local businesses (Boddewyn, 1988). Indirect costs include limits on firm actions that sometimes preclude the most efficient or desired course of action. Therefore, higher regulatory control reduces the flexibility of MNEs and may limit their strategic options, dissuading them from making investments (e.g., Brouthers, 2002; Loree and Guisinger, 1995). For example, Yiu and Makino (2002) found that areas with restrictive regulatory regimes increase the liability of foreignness for foreign firms, thereby enhancing the disadvantage of foreign firms relative to local firms especially because of the difference in knowledge of how to deal with local government. Zaheer and Mosakowski (1997) found that MNEs located in countries with a greater level of regulation had higher failure rates. These findings suggest a curvilinear (inverted U-shaped) relationship between regulatory control and the propensity of MNEs to internationalize in the local market. Applying the aforementioned semiglobalization framework, we offer the following hypothesis:

Hypothesis 2a: A curvilinear (inverted U-shaped) relationship exists between the propensity of MNEs to internationalize into a country and the regulatory control of its region.

Hypothesis 2b: A curvilinear (inverted U-shaped) relationship exists between the propensity of MNEs to internationalize into a country and the country’s ‘region-relative’ regulatory control.

Political institutional environment

Political democracy influences the attractiveness of internationalization into a country because it determines the risk that government leaders may change laws without proper checks and balances or input from the public (Harms and Ursprung, 2002; Jensen, 2003; Kobrin, 1979). Some research suggests that MNEs may choose to internationalize into more repressed areas under autocratic rule to obtain cost advantages in labor, reduce the risk of collective bargaining, and increase the likelihood of favorable deals with governments that allow them to exploit concentrations of power (Bucheli, 2008; O’Donnell, 1988; Rodrik, 1999). However, other studies suggest that the checks and balances of political democracy are attractive to investors because they limit unpredictable and sudden policy changes and place emphasis on the
quality of human capital (Blanton and Blanton, 2007; Henisz, 2008). This is because the potential use of unilateral power and unforeseen policy changes create significant uncertainty and risk (Busse and Hefeker, 2007; Harms and Ursprung, 2002; Jensen, 2003). Where political democracy is low, government is less transparent to business and its citizens, thereby allowing the potential for autocratic control, corruption, and political instability, all of which make inward FDI less attractive (Globerman and Shapiro, 2003; Orr and Scott, 2008). For example, Jensen (2003) found that political democracies offered greater institutional stability and therefore were more likely to attract FDI. When countries or regions with low political democracy are entered, greater transaction costs are experienced by the parent firm in drafting acceptable contracts, monitoring foreign business relationships, and developing measures to provide a flexible exit plan (Luo, 2005; Oxley, 1999). In support of this view, Harms and Ursprung (2002) found that political and civil repression negatively influenced inward FDI. Hence, MNEs are attracted to countries with high (rather than low) political and civil rights (Busse and Hefeker, 2007; Harms and Ursprung, 2002; Jensen, 2003). These findings suggest that MNEs are more likely to internationalize into countries with greater region-relative and regional political democracy, thus increasing an MNE’s degree of internationalization.

**Hypothesis 3a:** The propensity of MNEs to internationalize into a country is positively related to the political democracy of its region.

**Hypothesis 3b:** The propensity of MNEs to internationalize into a country is positively related to the country’s ‘region-relative’ political democracy.

**Economic institutional environment**

Strong economic institutions represent a locational advantage that can attract FDI (Dunning, 1988). Such ‘financial factors are an integral part of the growth process’ (Levine and Zervos, 1998: 554), which is conditioned by the capacities to produce and to consume (Letttau and Ludvigson, 2001), both requiring adequate capital. Capital investments serve as a proxy for well-developed economic institutions because the policies and actions of government, central banks, and private financial intermediaries provide for greater capital flow through capital availability and support market growth and liquidity (Agarwal, 1980; Bevan et al., 2004). The decisions emanating from economic institutions promote capital availability by such activities as issuing foreign debt in order to receive an influx of capital (Tirole, 2003) and increasing budget deficits, which is an action correlating with tax cuts or increasing government spending, which infuse capital into the market (Bohn, 1991).

Thus, the role of capital investments has also been heralded as a key determinant of FDI (Agarwal, 1980) because they create spillovers for MNEs and shape demand for and supply of resources, which in turn influence firms’ strategic and tactical actions (Burdekin and Weidenmier, 2001; Orphanides, 2002). Capital investments often create spillover effects from which MNEs can benefit. The economic geography literature suggests capital investments are shaped by governmental economic action and policy (Martin and Sunley, 2008; Romer, 1994). Capital investments lead to the learning and development of technology and knowledge resources, and as a result, greater capital flows in one country or region over another can explain higher concentrations of economic activity because of income differences, accessibility, infrastructure costs, and enhanced profitability (Barro, 1991; Martin and Sunley, 2008; Romer, 1994). Strong economic institutions attract more inward FDI because capital is needed by MNEs to support expansion and fund research and development, labor development, and production (Ajami and BarNiv, 1984; Beck et al., 2000; Globerman and Shapiro, 2003). Thus, it is important that capital be available, cost-effective, and stable in valuation. Capital investments are also vital because they provide the potential to profit from the wealth of citizens (Meyer and Nguyen, 2005). MNEs search for markets in which investors and consumers have significant financial resources and purchasing power, thus penetrating markets that have a higher return on capital (Agarwal, 1980). Consequently, MNEs are more likely to have a higher degree of internationalization into countries with stronger region-relative capital investments and with higher capital investments in the region.
Hypothesis 4a: The propensity of MNEs to internationalize into a country is positively related to the capital investment in its region.

Hypothesis 4b: The propensity of MNEs to internationalize into a country is positively related to the country’s ‘region-relative’ capital investment.

METHOD

Data source and sample

We used data from Kaigai Shinshutsu Kiyousoran [Japanese Overseas Investments] which provides subsidiary-level information on the overseas activities of Japanese MNEs. The database has been found to provide reliable data for the study of Japanese FDI (e.g., Delios and Henisz, 2003; Goerzen and Beamish, 2005). We selected Japanese MNEs that had foreign subsidiaries in more than one country. Single-host country MNEs were not included because no region-level strategy for these firms could be ascertained. Moreover, including this type of firm in the sample could bias the results because it could mask potential region and corporate effects, thus creating biases in the Level-2 and Level-3 models (Bowman and Helfat, 2001; Makino, Isobe, and Chan, 2004). Therefore, our results are valid for MNEs with foreign subsidiaries in more than one host country. The final sample is composed of 1,076 Japanese MNEs having established 3,394 new foreign subsidiaries in 45 different countries over the period 1996–2001 (see Appendix 1 for the number of new FDIIs created per country and per year).

Levels of analysis

We tested our hypotheses with models measured and analyzed at three levels: firms’ foreign subsidiary choices and location characteristics in a country (Level 1), firms’ foreign subsidiary choices and location characteristics in a region (Level 2), and firms’ corporate (headquarters) (Level 3) variables. Level 3 allows us to control for a firm’s corporate-level effects.

We conceptualize regions in geographic terms and we define a region as a grouping of countries with physical continuity and proximity (Arregle et al., 2009; McNamara and Vaaler, 2000; Rugman and Verbeke, 2004). While different operationalizations exist (see Aguilera, Flores, and Vaaler, 2000; Rugman and Verbeke, 2007). Although regional clusters based on cultural dimensions have some value, they are less relevant for corporate strategy. Moreover, in recent years, scholars have argued for further integration of economic geography in the examination of spatial dimensions of MNE strategy (Buckley and Ghauri, 2004). Indeed, geographic proximity has been found to stimulate trade, investment, and even convergence in governance and management practices across countries (Ghemawat, 2003; Khanna, Kogan, and Palepu, 2006). Finally, physical distance matters for FDI and affects the way firms operate internationally (Nachum and Zaheer, 2005) and is even more important to the two primary drivers of semiglobalization (see theory sections). We therefore grouped the 45 countries used in this study into 8 geographical regions derived from the region classification proposed by the United Nations Statistics Division (2008) (see Appendices 2 and 3 for the composition of these regions and their profiles).6

4 However, it is important to note that MNEs having subsidiaries in several countries may or may not have a region-level strategy. This sample only allows us to examine the relevance of the semiglobalization perspective by including tests for both country level and region-relative strategies.

5 These 45 countries cover 91 percent of all the international joint-ventures and FDIs made by Japanese MNEs in Kaigai Shinshutsu Kiyousoran and include countries and regions commonly examined in the literature on semi-globalization or FDI activities of MNEs.

6 Because 1,960 foreign subsidiaries in our sample were located in Asia, we had to separate Asia into additional regions to achieve a more fine-grained understanding of foreign investment dynamics there. The logic used to define these Asian regions was a geographical approach based on the ASEAN region to divide Asia into three parts: ‘Southeast Asia,’ with countries belonging to the ASEAN trading block, ‘East Asia,’ with countries to the east of the ASEAN region, and ‘Northwest Asia,’ with countries on the northwest of the ASEAN region. This geographical approach considers a trading block as creating a geographical region with some institutional homogeneity to facilitate an institutional region-relative evaluation. Moreover, Japanese firms consider ASEAN as a relevant region for their FDI decisions in Asia (Belderbos and Zou, 2006).
Dependent variable

The MNE’s degree of internationalization into country $c$ is measured as: (the number of foreign subsidiaries created [i.e., inflows] by the MNE in country $c$ over the period 1996–2001) $\times$ [their relative importance over the period 1996–2001]). For the MNE, the score ‘Relative importance over the period 1996–2001’ for a country $c$ is measured by the ratio:

$$\frac{\text{Total number of employees in new foreign subsidiaries created in country } c \text{ (1996–2001)}}{\text{Total number of employees in all of the firm’s foreign subsidiaries (1996–2001)}}$$

This measure is more fine-grained than unidimensional measures and is similar to that used by others such as Hitt et al. (2006). Unidimensional measures (e.g., number of subsidiaries, employees, sales) have various problems as they focus on one facet of internationalization, thus only partially reflecting the MNE’s internationalization (Hitt et al., 1997; Sanders and Carpenter, 1998).\(^7\) This multidimensional measure better captures the MNE’s internationalization (Hitt et al., 1997; Lu and Beamish, 2004) as it reflects the breadth of internationalization into a country (i.e., the number of foreign subsidiaries) and its depth (i.e., the degree of commitment to each country based on the relative number of employees) simultaneously. The breadth is a measure of the structural attribute of the degree of internationalization (Sullivan, 1994) and reflects the governance and coordination costs associated with internationalization, which are compounded if an MNE expands the number of FDIs in which it operates (Hitt et al., 1997; Lu and Beamish, 2004; Sanders and Carpenter, 1998). This measure is developed at the country-level because our objective is to relate the MNE’s strategic investment decisions in a country to that country’s institutional environment. The MNE receives a score on this variable for each one of the 45 countries in our sample. Hence, the MNE with a high score for a country on this variable indicates that it has a strong level of internationalization into this specific country.

Independent variables

We measure the MNE’s prior internationalization into a region by the number of its prior foreign subsidiaries established in a region (1990–1995) multiplied by their relative importance (1990–1995). We apply the same method as for our dependent variable but at the region level and over the period 1990–1995.

We investigate the effects of formal institutions within a country and a region, representing the regulatory, political, and economic institutional environments, on an MNE’s degree of internationalization into a country. We used composite measures (e.g., Gaur et al., 2007), created and validated by Holmes et al. (2013), to ensure the validity and breadth of the measures.\(^8\) Factor scores were created based on 34 comprehensive measures of institutions in 50 countries from 1995 to 2003, which are described in more detail in Holmes et al. (2013). The results produced four constructs used in our two-level models: regulatory control, political democracy, capital availability, and market liquidity.\(^9\) These factors clearly proxy three formal institutions: regulatory, political and economic and are described below.

Regulatory control

The regulatory control factor measures the degree of government involvement in business through

\(^7\)To check the robustness of our results, we also measured an MNE’s degree of internationalization into country, for our dependent and independent variables, using an MNE’s number of employees and an MNE’s number of FDIs. These two alternative unidimensional measures gave qualitatively the same results as those reported in this paper, confirming the stability of our results to different operationalizations of the measure of internationalization.

\(^8\)This method is similar to the procedure used by Chan et al. (2008) and Gaur et al. (2007), but more institutional characteristics were used and a different rotation technique was applied in the factor analyses.

\(^9\)The objective was to allow factors to be correlated, using oblique rotation, because theory suggests that the informal institutions shape formal institutions, suggesting they may have some common origins (see Holmes et al., 2013). Oblique rotation yields information on the intercorrelations and the potential existence of hierarchical factors. In a sample of 50 countries, the highest correlation between institutional factors is between political democracy and regulatory control (−0.39, $p < 0.001$), and the lowest correlation is between capital availability and market liquidity (0.02, $p > 0.05$) and between market liquidity and regulatory control (0.02, $p > 0.05$). As reported in Holmes et al. (2013), these factors were stable in composition, conceptually distinct, and had a high discriminant validity and internal reliability.
laws, regulations, and government policies (Busenitz, Gomez, and Spencer, 2000), which constrain behavior through rule-setting, monitoring, and sanctions (Scott, 1995). This variable is measured by a country’s regulatory burden, trade policy, foreign investment restrictions, contract and property rights, government intervention in banking, informal markets, and monetary policy. All measures loaded positively (factor loadings > 0.50), reflecting greater regulatory control. A high score suggests that the country operates with broader and more restrictive regulatory oversight and involvement.

**Political democracy**

The political democracy factor refers to the level of discretion and power a government maintains over its citizenry, measured through the country’s civil liberties, political rights, executive political restrictions, and political constraints. A high score suggests that the government is democratic, granting more rights and liberties to its citizens and having constraints to further protect these rights. Civil liberties and political rights are reverse coded in the data because higher scores indicate fewer rights; they loaded negatively on this factor (−0.76 and −0.87). Executive political restrictions and political constraints, which capture the level of checks and balances that prevent a concentration of power in government, loaded positively (0.96 and 0.68) on this dimension.

**Capital investments**

Two factors (3 and 4) were found that indicated prerequisites for capital investments in a country. On Factor 3, items indicating increased capital in an economy, capital investments, money supply, net reserves, nominal GDP, and total foreign debt loaded positively (loadings > 0.70). Budget balance loaded negatively (−0.73) as the balancing of a country’s budget reduces the ability of the government to reinvest capital into the economy. This factor, **Capital Availability**, captures the availability of capital for domestic entities, with a higher score implying a greater availability of capital for commerce in the country.

Liabilities, exchange rate, and liquidity loaded on Factor 4, which indicates the lack of market liquidity and capital investments. Liabilities, which loaded positively on this factor (0.78), result in lower liquidity in domestic firms due to higher debt. Increases in exchange rates (factor loading of 0.64) reduce cash flow due to the depreciation of the nation’s currency and result in lower liquidity (Grilli and Roubini, 1995). Liquidity loaded negatively on this factor (−0.72) as it reflects the ease of converting an asset through transactions. Factor 4 is labeled **Market Liquidity**, reflecting the degree to which a country curtails or manages the rapid expansion of its money supply and assets, with higher scores indicating lower capital investments because of the lack of assets available in the market for reinvestment. Both of these economic factors are used to compute semiglobalized institutional variables (see below) to test Hypotheses 4a and 4b.

To test our hypotheses, we adapt these variables and compute two new measures for each institutional variable: a region-level measure of institutions and a country-level measure of institutions (a region-relative variable). Using the eight regions specified, we calculate for each institutional variable a region-level institutional variable as the weighted average institutional score for this variable of all countries in a region. We weight the institutional scores of countries in the same region by their GDP (the ratio of a country’s GDP/sum of the GDPs of countries in the same region) to take into account the different economic importance of countries in the same region (e.g., Hejazi, 2007). We use this average to represent the general (central tendency) institutional environments for a region with differences taken into account by region-relative variables. The country-level region-relative variable captures a country’s score on an institutional variable relative to the countries in the same region, not relative to all other countries, and is calculated as: country’s original institutional score minus its respective region-level institutional score. This way of analyzing institutional variables reflects the semiglobalization perspective.

**Control variables**

At the country level, we controlled for a firm’s prior internationalization into a country measured

10 Hence, we expect a negative coefficient for Market Liquidity to validate H4a or H4b.

11 For instance, if a country has a Regulatory Control value of 1.2 and is in a region with a weighted average Regulatory Control value of 0.4, its value for ‘Regulatory Control-Country’s region-relative’ score is (1.2 − 0.4) = 0.8.
with the same computation as our dependent variable but over the 1990–1995 period. A firm’s country experience was measured by the log of the sum of subsidiary years of experience in a firm’s history in the focal country (Lu, 2002). Institutional isomorphism (mimetic) effects were estimated by country experience of all Japanese firms (Henisz and Delios, 2001; Lu, 2002), calculated as the log of the number of subsidiary years experience of other Japanese firms in a country. We also control for country-specific variables, and, relying on recent studies (e.g., Chan, Makino, and Isobe, 2006), we include per capita income (as the log of GDP per capita [Vaaler, 2008]), economic growth (the GDP per capita growth rate [Vaaler, 2008]), population (as the number of individuals in a country), and cultural distance (between a host country and Japan). Cultural distance was measured using Gaur and Singh’s (1988) measure and is calculated by summing standardized differences between the cultural dimensions reported in Hofstede (1980) (e.g., Gaur et al., 2007).

At the firm level, we measure the firm’s total prior international experience as the logarithmic transformation of the number of subsidiary years of investment in a firm’s history in all countries (Delios and Henisz, 2003), the firm’s research and development intensity (R&D expenses divided by total sales—1990–1995 average), and advertising intensity (advertising expenses divided by total sales—1990–1995 average) (Delios and Henisz, 2003). Finally, firm size is measured by the log of its annual sales (in 1995).

Model estimation
As preliminary analyses indicate an over-dispersion in our limited range dependent variable,12 we use a negative binomial model as this is appropriate for the analysis of data with such a distribution (Cameron and Trivedi, 1998). Due to the structure of the data and the hierarchical nature of our research question, we use multilevel negative binomial models with two and three levels and analyze the data with the multilevel software SuperMix (Hedeker et al., 2008).13 Multilevel models address the potential statistical problems inherent in multilevel data and allow the identification of effects occurring at each level (country, region, and headquarters levels) and across levels (Arregle, Hebert, and Beamish, 2006; Hitt et al., 2007). To compare and identify best models, we used the Aikake Information Criterion (AIC) and the Bayesian Information Criterion (BIC). These are the relevant statistics as they allow for the comparison of mixed models with different numbers of levels and predictors (Burnham and Anderson, 2004).14

RESULTS
The intercorrelation matrix and descriptive statistics for each variable are presented in Table 1. The results of multilevel model predicting an MNE’s degree of internationalization into a country are presented in Models 4 and 5 in Table 2 (first putting in Model 4 only the first-order term for the quadratic effect in Hypothesis 2 before adding the second-order term in Model 5 (Cohen et al., 2003)). To check the validity of our results, we test models without the region level in Models 1 and 2, and with the region level but without our institutional variables in Model 3. Considering the AIC and BIC, Model 4 is the best model.

First, the coefficient in Model 4 for the variable ‘Prior internationalization into a region’ (0.71, p < 0.05) shows that an MNE’s prior level of internationalization into a region has a positive effect on its propensity to internationalize into a country of the region. Therefore, Hypothesis 1 receives support.

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12 A Poisson model assumes that the true variance of the dependent variable equals its mean. When the variance exceeds the mean, we have an over-dispersion that can be addressed with a negative binomial model. We tested for over-dispersion applying a Likelihood Ratio test based on a multilevel Poisson and a multilevel negative binomial (Cameron and Trivedi, 1998). Using Model 4, (Deviance of the Poisson—Deviance of the negative binomial) = 42 compared to a χ² critical value of 2.70 for a one-sided 0.05 test. There was an overdispersion in our data and we had to use a negative binomial.

13 We conducted a Likelihood Ratio test (on Model 4) to verify the relevance of a multilevel model versus a fixed-effects model. The result of the LR test confirmed the difference between these two types of model (χ² = 268.63, p = 0.000) and the need to use a multilevel model for our data.

14 As there is a debate about the relative advantages of the BIC vs. the AIC, it is recommended to find models favored by both criteria (i.e., lowest AIC and BIC) (Kuha, 2004). Individual AIC and BIC values are not interpretable and the relevant information for selecting the best model is the difference (Δ) between a model’s AIC and BIC and the AIC and BIC values of the model with the lowest AIC or BIC. (Burnham and Anderson, 2004). This difference indicates the loss of information experienced if we use the model with the highest AIC or BIC compared to the (best) model with the lowest AIC or BIC.
<table>
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<th>Variables</th>
<th>Mean</th>
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<td>Population (1,000,000)</td>
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<tr>
<td>Per capita income</td>
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<td>0.14*</td>
<td>0.21*</td>
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<td>-0.20*</td>
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<td>-0.00</td>
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<td>0.19*</td>
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<tr>
<td>R&amp;D intensity</td>
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<td>0.02</td>
<td>0.00</td>
<td>0.08*</td>
<td>0.00</td>
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<td>0.19*</td>
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<tr>
<td>Firm size</td>
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<td>1.35</td>
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<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
<td>0.61*</td>
<td>0.00</td>
<td>0.10*</td>
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<tr>
<td>Prior internationalization —region</td>
<td>0.29</td>
<td>1.02</td>
<td>0.21*</td>
<td>0.32*</td>
<td>0.06*</td>
<td>0.00</td>
<td>0.07*</td>
<td>0.01</td>
<td>0.14*</td>
<td>0.23*</td>
<td>0.00</td>
<td>0.06*</td>
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<tr>
<td>Regulatory control —region</td>
<td>-0.08</td>
<td>0.74</td>
<td>-0.10*</td>
<td>-0.14*</td>
<td>-0.18*</td>
<td>-0.27*</td>
<td>-0.72*</td>
<td>-0.14*</td>
<td>-0.29*</td>
<td>0.00</td>
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<tr>
<td>Capital availability —region</td>
<td>0.25</td>
<td>0.79</td>
<td>0.23*</td>
<td>0.22*</td>
<td>-0.01*</td>
<td>0.04*</td>
<td>0.37*</td>
<td>0.15*</td>
<td>0.37*</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
<td>0.16*</td>
<td>-0.50*</td>
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<tr>
<td>Political democracy —region</td>
<td>-0.03</td>
<td>0.67</td>
<td>-0.05*</td>
<td>-0.11*</td>
<td>-0.04*</td>
<td>-0.23*</td>
<td>0.44*</td>
<td>0.20*</td>
<td>-0.10*</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
<td>0.03*</td>
<td>-0.51*</td>
<td>0.34*</td>
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<tr>
<td>Market liquidity —region</td>
<td>0.27</td>
<td>0.56</td>
<td>0.10</td>
<td>-0.12*</td>
<td>-0.17*</td>
<td>-0.28*</td>
<td>0.06*</td>
<td>0.08*</td>
<td>-0.50*</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
<td>-0.04*</td>
<td>-0.18*</td>
<td>0.12*</td>
<td>0.15*</td>
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<tr>
<td>Regulatory control —country’s 'region relative'*</td>
<td>-0.07</td>
<td>0.80</td>
<td>-0.06*</td>
<td>-0.12*</td>
<td>-0.11*</td>
<td>0.27*</td>
<td>-0.39*</td>
<td>0.15*</td>
<td>-0.17*</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
<td>0.05*</td>
<td>-0.22*</td>
<td>0.23*</td>
<td>0.15*</td>
<td>0.16*</td>
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</table>
Hypotheses 2a and 2b predict an inverted U-shaped effect for (1) the region’s regulatory control and (2) the country’s region-relative regulatory control on the propensity of an MNE to internationalize into a country. Model 5 shows statistically nonsignificant coefficients for the squared term of country region-relative regulatory control (0.18, p > 0.05) and the squared term of regional regulatory control (0.56, p > 0.05). Thus, neither Hypothesis 2a nor Hypothesis 2b receives support. Model 4, testing linear effects, shows a negative and statistically significant coefficient for regional regulatory control (−0.72, p < 0.01) and a negative but statistically nonsignificant coefficient for country region-relative regulatory control (−0.20, p > 0.05).

Hypotheses 3a and 3b predict a positive effect of (1) the region’s political democracy and (2) the region-relative political democracy of a country on the propensity of a firm to internationalize into a country. We thus have intriguing results: contrary to our expectations, there is a statistically significant negative relationship between the propensity of MNEs to localize foreign investment and a region’s political democracy (−0.56, p < 0.001) and a country’s region-relative political democracy (−0.11, p < 0.05) in Model 4. Therefore, Hypotheses 3a and 3b do not receive support even though the importance of the region and that of the country’s region-relative institutional variables are confirmed. The semiglobalization effect applies to this institutional factor but not in the expected direction.

Hypotheses 4a and 4b stated that (1) capital investments of the region and (2) the country’s region-relative capital investments are positively related to a firm’s propensity to internationalize in a given country. In Model 4, the effect of capital availability in a region is positive and statistically significant (0.25, p < 0.05). The effect of market liquidity, which reflects the lack of capital investments, is not statistically significant (−0.09, p > 0.05). Therefore, Hypothesis 4a receives partial support. The effect of region-relative capital availability is positive and statistically significant (0.56, p < 0.001), and the effect of region-relative market liquidity is negative and statistically significant (−0.23, p < 0.05). Thus, Hypothesis 4b receives support.

We know from previous research that country-level institutions affect the attractiveness of FDI destinations and the location choices of MNEs.
However, for the aforementioned reasons, models reflecting the semiglobalization effect should explain more accurately the effect of institutional variables on MNEs’ FDI s compared to a country-only approach. Hypotheses 2–4 test the value and significance of the semiglobalized institutional dimensions but do not show their additional value relative to the more traditional framework, which is the central contribution of this research. Therefore, we investigate whether the three-level model with regional and region-relative institutional effects (Model 4) accounts for additional variance in FDI localization decisions compared to the model with country-level institutional effects (Model 2): Model 4 clearly produces a much better explanation of internationalization (lower AIC and BIC). These results provide strong support for the notion that, compared to a country-level constrained model, a semiglobalization perspective offers a better explanation of these relationships.

**Robustness checks**

While the semiglobalization perspective tends to conceptualize regions in terms of geography, several other operationalizations of regions have been based on trading blocks, culture, or institutions. Therefore, we developed several models using alternative definitions of regions as post hoc tests to check the robustness of our results compared to other existing definitions of regions. We ran the same three-level model (i.e., Model 4) with the following definitions of regions: trading blocks, culture, and institutions. For trading blocks, we used...
the regions defined by UNCTAD (2001); for culture, we used two definitions: Ronen and Shengkar (1985) and GLOBE (Gupta, Hanges, and Dorfman, 2002); for institutions, we used La Porta et al. (1998) (see Appendix 4). All of the alternative models show larger BIC and very large AIC differences relative to Model 4 (see Appendix 4). These differences clearly indicate that the alternative definitions of regions do not provide as good of a test of the research question as does the geographic definition of regions used in Model 4.

**DISCUSSION**

This research examines the effects of the institutional environment on MNE location choices of internationalization using a more comprehensive and richer approach that complements and extends previous research. We argue for the importance of a ‘semiglobalized’ institutional perspective and test it by examining how MNEs implement their strategic approach to country institutional environments on MNE location choices of internationalization using a more comprehensive analysis of the effects of institutional environments in these decisions as two-level models provide significant results, but the semiglobal framework (i.e., Model 4) produces a more complete explanation with different effects for the four institutional variables. Thus, country-based models (i.e., Model 2) may provide incomplete conclusions about the role of institutions in MNEs’ internationalization decisions. This outcome addresses the important question of the relevant level of analysis for examining the influence of institutions on MNE strategy, and it has major implications for both scholars and practitioners regarding the influence of institutions on MNEs. If we compare countries’ institutional propensity to attract FDI obtained from the three-level model (Model 4) with the two-level model (Model 2), the average difference between them is 32 percent, which is nontrivial.

For each country, we present in Figure 1 (left side) its score for propensity to attract MNEs’ internationalization resulting from our semiglobalized institutional variables and from the traditional country-level institutions. These results in Figure 1 also identify countries that benefit (e.g., Poland, Taiwan) or suffer (e.g., Chile, Mexico) from this semiglobal assessment of their FDI attractiveness and why. This outcome for a country is explained by the complex interplay between its region’s institutional attractiveness, its region-relative institutional attractiveness, and their relative values (both scores are listed in the right side of Figure 1).

The semiglobalization approach also produces results that reinforce the importance of the
Geographic Regions, Institutions and MNEs' Strategy

Figure 1. Propensity scores to internationalize into a country computed on the four institutional variables: country-level score (Model 2) vs. semiglobal score (Model 4) (left side) and its components (right side). N.B.: as we use a negative binomial, the semiglobal institutional score (left side of the Table) = (Region’s attractiveness score) × (Country’s relative attractiveness score) (right side of the Table) as $\exp(a + b) = \exp(a) \times \exp(b)$.

institutional environment for MNEs’ FDI decisions. At the region level, regulatory control and political democracy have a negative effect on foreign investments. Alternatively, the region’s capital investments motivate foreign investments. Our results on regulatory control suggest that it creates costs and overwhelms any positive effects, thereby discouraging FDI. Thus, perhaps the threshold at which regulatory control facilitates MNE’s localization is relatively low. The results for political democracy are contrary to our expectations, suggesting that MNEs may not favor democratic regions. Accordingly, lack of political democracy in a country does not appear to be a major
impediment to foreign investments, but instead may encourage FDI, indicating MNEs’ desire to achieve greater efficiency (Adam and Filippaios, 2007). Perhaps high levels of governmental discretion (relative to decentralized autonomy to citizens and businesses) allow MNEs to reduce the risks and costs that occur when workers collectively mobilize for such actions as protests, strikes, or litigation. While political democracy is often associated with stability, it also results in more regular regime change, thus prompting changes in policies (Jensen, 2003). Additionally, prior research suggests that some MNEs may be able to negotiate favorable terms that shield them from public demands and competition through close relationships with more autocratic governments (Fagre and Wells, 1982; Li and Resnick, 2003). In fact, some of these agreements may be negotiated with corrupt officials (i.e., Bueno de Mesquita et al., 2004; Jensen, 2003). In addition, fewer political and human rights afforded to citizens may result in lower workforce costs (Rodrik, 1999). The results may also suggest the need to examine further the effects of regulatory and political institutions in future research on FDI in order to understand their impact more fully. Our results are consistent with those of Li and Resnick (2003), who found that, when controlling for property rights regulations, the relationship between political democracy and FDI is negative. We believe that each explanation likely undergirds the rationales for some firms’ actions. At the country level, it appears that MNEs seek out those countries in a region that have fewer constraints on business activities and more market liquidity. We also found that greater region-relative political democracy reduces the likelihood of internationalization into a country, most likely for the reasons suggested above. Alternatively, a country’s higher region-relative capital investments promote greater internationalization in the country.

However, this semiglobalization behavior does not necessarily apply to all firms. If the MNE cannot use at least one of the two mechanisms related to semiglobalization (RFSAs and regional organization learning), it has few incentives to adopt a semiglobalization approach. For instance, it is possible that some MNEs might decide to locate FDI in only one foreign country without targeting or expanding into its corresponding region. Two main reasons could explain such behavior: the absence of regionally fungible resources or an idiosyncratic desire to focus only on a certain, probably large and attractive, country.

IMPLICATIONS, LIMITATIONS, AND CONCLUSIONS

Our results have five crucial implications for theory and research on international strategy. First, our study demonstrates the effects of regions on MNE’s internationalization decisions. Second, this research shows that MNEs’ evaluation of institutions in their internationalization decisions (location and amount) is more comprehensive than suggested by prior research. MNEs appear to decide their location choices for internationalization in part based on a country’s institutions relative to the institutions of other countries in the same region (i.e., in a region-relative manner). Such decisions allow firms to leverage and optimize their investments across the region, thereby controlling the risk while enhancing the benefits and returns across the countries within the region. Hence, the third contribution is the support provided for the semiglobalization perspective and its relevance to understanding institutional effects. Such an approach changes the way we measure, evaluate, and understand the institutional effects on FDI for MNEs. It indicates that future research dealing with institutions and MNE performance should consider and measure institutions differently than in past research. Fourth, we found variance in the importance of different institutions at the country and region level; that is, attracting foreign investments through an institutional strategy at the region and country levels assumes different strategies with different actions at each level. Finally, our results highlight the relevance of geographic regions and the value of using multilevel models to examine important strategic decisions.

These results have important managerial and policy implications, as well. For managers of
MNEs, they must be aware of institutional environments and their effects not only at the country-level but also at the region-level if they want to gain the benefits of arbitrage. This research informs the decision-making process of managers and MNE organizations by highlighting the way in which they can evaluate and coordinate the influence of specific institutional environments. For policy makers, the results of this study highlight the importance of the regional dimension of the international institutional competition to attract FDIs. Our results emphasize the potential value of collaboration among country governments across a region in their competition with other regions for foreign investments. Regional integration can be designed to increase FDI inflows to a region (Naya and Plummer, 1997) and the results in Model 4 give new and unique insights into which institutions should be considered by governments in order to attract FDI. For instance, reducing regional regulatory control may have the strongest effect16 among region-level institutional factors. However, countries in the same region are also in competition for primary direct investments as MNEs compare their institutional environments to select the best country(ies) in the region, representing another form of co-opetition (Brandenburger and Nalebuff, 1996), which is likely to be challenging. Hence, cohesion within the region needs to be maintained to avoid triggering dysfunctional intra-regional competitive behaviors (Oxelheim and Ghauri, 2008). Depending on the level of changes targeted by a country, our results also provide some guidelines about whether it would be possible by repositioning the country versus its regional partners or by repositioning the region versus other regions.

As in other studies, this research has some limitations. First, its hypotheses are tested using Japanese MNEs over a specific period of time (1996–2001). The institutional environment of Japan may influence the strategies taken by these firms or the relevant definition of geographic regions, and there are opportunities for future research to study these questions with MNEs based in other regions. Second, it would be interesting to replicate this study with data for other periods of time as the institutional environments of countries and regions can change, resulting in different institutional environments. However, such potential changes do not undermine the core logic of this work or the relative superiority of the semiglobalized effects of institutional variables as hypothesized herein. Third, although we measure the effects of country-level and region-level institutions and the key role of regions, we do not consider how these different levels are integrated in the decision-making process. Do MNEs start their internationalization decision-making process from the region level, from the country level, or in tandem? Knowing that MNEs use a semiglobal institutional analysis, future research should examine the MNE decision-making process to understand its links with the firm’s structure and other organizational processes. Such research will likely require data from MNE decision-makers, starting with the first decision up to the final decision to locate an FDI in a country to be able to disentangle the interactions between regional and country effects. Finally, although our approach using geographic regions provides an effective way of measuring such regions, as shown by the robustness tests, future research might explore other geographic regions, such as smaller regions within Europe.

In conclusion, this work uniquely merges traditional institutional perspectives with a semiglobalization perspective to examine the effects of the country environment and of the general institutional environment of a region on internationalization decisions. Our results suggest that the internationalization of MNEs is influenced by the general institutional environment of both countries and regions. Thus, this study introduces a new perspective regarding institutional influences on the international strategy of MNEs.

ACKNOWLEDGEMENTS

We thank our Associate Editor, Kulwant Singh, and the two anonymous reviewers for their helpful and developmental feedback. In addition, we acknowledge the helpful comments from Shih-Fen Chen, Charles Dhanaraj, Alan R. Rugman, and Laszlo Tihanyi during the development of this paper. An earlier version of this paper was presented at the Academy of Management’s annual conference (2009).

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16 As our institutional independent variables had equal variances as factor scores, the resulting coefficients largely proxy standardized coefficients in which the relative weights can be interpreted.
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APPENDIX

Appendix 1. Number of new FDIs (i.e., inflows) by country and by year

<table>
<thead>
<tr>
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<th></th>
<th></th>
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<tr>
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<td>Turkey</td>
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Year                  | Number of new FDI created |
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<td>2001</td>
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Appendix 2. Composition of regions

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<th>Countries</th>
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<td>Mexico</td>
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<td>Peru</td>
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<td>Brazil</td>
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<td>Australia</td>
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<td></td>
<td>Sweden</td>
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<td>New Zealand</td>
</tr>
<tr>
<td></td>
<td>Portugal</td>
<td></td>
<td>China</td>
</tr>
<tr>
<td></td>
<td>Spain</td>
<td>East Asia (979 FDIs)</td>
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<td>Italy</td>
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<td>Hong Kong</td>
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<tr>
<td></td>
<td>Finland</td>
<td></td>
<td>South Korea</td>
</tr>
<tr>
<td></td>
<td>Austria</td>
<td>Northwest Asia (80 FDIs)</td>
<td>India</td>
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<td>Greece</td>
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<td>Pakistan</td>
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<td>Denmark</td>
<td>South East Asia (901 FDIs)</td>
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<td>Ireland</td>
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<td>Vietnam</td>
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<td>Slovenia</td>
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</table>

Appendix 3. Profiles of regions on the four institutional variables

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<th>Region</th>
<th>Weighted region-average institutional values</th>
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<tr>
<td></td>
<td>Regulatory control</td>
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<tr>
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<td>Europe</td>
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<tr>
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<tr>
<td>South America</td>
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<tr>
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<tr>
<td>South East Asia</td>
<td>0.27</td>
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</tbody>
</table>

Appendix 4. Post hoc tests—models explaining an MNE’s degree of internationalization into a country over the period 1996–2001—other definitions of regions

<table>
<thead>
<tr>
<th>Variable</th>
<th>Trading blocks</th>
<th>Culture (Ronen—Shenkar)</th>
<th>Culture (GLOBE)</th>
<th>Institution (La Porta et al., 1998)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Intercept</td>
<td>−3.26*</td>
<td>−5.23**</td>
<td>−0.41*</td>
<td>−3.18*</td>
</tr>
<tr>
<td>Level—firm’s headquarters</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Advertising expense</td>
<td>−4.29</td>
<td>−3.80</td>
<td>−4.25</td>
<td>−4.53</td>
</tr>
<tr>
<td>R&amp;D</td>
<td>4.91**</td>
<td>5.16**</td>
<td>5.05**</td>
<td>4.39**</td>
</tr>
<tr>
<td>Total prior international experience</td>
<td>−0.11*</td>
<td>−0.12*</td>
<td>−0.11*</td>
<td>−0.10</td>
</tr>
</tbody>
</table>
### Variable | Trading blocks | Culture (Ronen—Shenkar) | Culture (GLOBE) | Institution (La Porta et al., 1998)
---|---|---|---|---
Firm size | 0.15*** | 0.13** | 0.13** | 0.15***

**Level—firm/country**
- Prior internationalization into a country | -0.01 | 0.09 | 0.05 | 0.10
- Country experience | 0.30*** | 0.31*** | 0.30*** | 0.32***
- Country experience of all Japanese firms | 0.80*** | 0.70*** | 0.93*** | 1.01***
- Population (/1,000,000) | -0.00* | -0.00 | -0.00*** | -0.00*
- Per capita income | -1.08*** | -0.71** | -1.44*** | -1.24***
- Economic growth | 14.98*** | 12.96** | 14.10** | 21.77***
- Cultural distance | -0.04 | -0.16 | -0.04 | -0.07
- Regulatory control—country’s ‘region-relative’ | -0.34* | -0.06 | -0.22 | -0.48**
- Capital availability—country’s ‘region-relative’ | 0.52*** | 0.41*** | 0.47*** | 0.35***
- Market liquidity—country’s ‘region-relative’ | -0.07 | -0.12 | -0.17 | -0.25*
- Political democracy—country’s ‘region-relative’ | -0.27** | -0.17* | -0.08 | -0.19**

**Level—firm/region**
- Prior internationalization into a region | 0.05** | 0.04*** | 0.04*** | 0.00
- Regulatory control—region | -0.86*** | -0.42 | -1.32** | -2.45***
- Capital availability—region | 0.27** | 0.70*** | 0.18 | -0.83*
- Market liquidity—region | -0.56** | -1.26** | -1.02** | 0.01
- Political democracy—region | -0.19* | -0.22 | -0.08 | -1.12*
- Goodness of Fit: Akaike information criterion | 4,340 | 4,383 | 4,353 | 4,373
- $\Delta = \text{AIC}_{(model)} - \text{AIC}_{(lowest AIC: Model 4)}$ | 24 | 67 | 37 | 57
- Bayesian information criterion | 4,441 | 4,484 | 4,454 | 4,474

***p < 0.001; **p < 0.01; *p < 0.05.

**Post Hoc** tests—other definitions of regions.

We used the definitions of regions proposed by the different authors. As some of our 45 countries were not always considered in these typologies, we added them as independent countries and identified them as ‘other independent countries.’

Regions ‘Trading blocks’ (UNCTAD, 2001): EU (United Kingdom, Netherlands, France, Germany, Sweden, Portugal, Spain, Italy, Finland, Austria, Greece, Denmark, Ireland), NAFTA (USA, Canada, Mexico), MERCOSUR (Colombia, Venezuela, Peru, Chile, Brazil, Argentina), ASEAN (Thailand, Singapore, Vietnam, Malaysia, Philippines, South Korea, Indonesia), ANZCERTA (Australia, New Zealand). Other independent countries: Russia, Romania, Slovenia, Bulgaria, Czech Republic, Hungary, Poland, Romania, India, Pakistan, China, Hong Kong, Switzerland, Taiwan, Turkey.

Regions ‘Culture’ (Ronen and Shenkar, 1985): Anglo (Australia, Canada, Ireland, New Zealand, USA, United Kingdom), Latin Europe (France, Italy, Spain, Portugal), Nordic Europe (Denmark, Finland, Sweden), Germanic Europe (Austria, Germany, Switzerland, Netherlands), Latin America (Argentina, Chile, Mexico, etc.), Far Eastern (China, Hong Kong, Indonesia, South Korea, Malaysia, Taiwan, Thailand), Near Eastern (Greece, Turkey), Brazil, India. Other independent countries: Pakistan, Russia, Romania, Slovenia, Bulgaria, Czech Republic, Hungary, Poland, Romania.

Regions ‘Culture GLOBE’ (Gupta et al., 2002): Anglo (Australia, Canada, Ireland, New Zealand, US, United Kingdom), Latin Europe (France, Italy, Spain, Portugal, Switzerland), Nordic Europe (Denmark, Finland, Sweden), Germanic Europe (Austria, Germany, Netherlands), Eastern Europe (Russia, Hungary, Poland, Romania, Slovenia, Bulgaria, Greece), Latin America (Mexico, Colombia, Venezuela, Peru, Chile, Brazil, Argentina), Arab culture (Turkey), Southern Asia (India, Indonesia, Philippines, Malaysia, Thailand), Confucian Asia (Taiwan, China, Hong Kong, South Korea, Singapore). Other independent countries: Pakistan.

Regions ‘Institutions’ (La Porta et al., 1998): English-origin (Australia, HK, Canada, India, Ireland, New Zealand, Pakistan, Singapore, Thailand, United Kingdom, USA), French-origin

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(Argentina, Brazil, Chile, Colombia, France, Greece, Indonesia, Italy, Mexico, Netherlands, Peru, Philippines, Spain, Portugal, Turkey, Venezuela, Vietnam), German-origin (Austria, Germany, South Korea, Switzerland, Taiwan), Scandinavian-origin (Denmark, Finland, Sweden). Other independent countries: Russia, Romania, Slovenia, Bulgaria, Czech Republic, Hungary, Poland, Romania.