

**AN INVESTIGATION OF FIRM RESPONSES TO RAPID VS. CONTINUOUS
INSTITUTIONAL CHANGE: DYNAMIC VIEW OF FIRM PERFORMANCE
AT POST-ENTRY**

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ABSTRACT

This dissertation consists of three essays broadly centering on external changes and how organizations respond to these change by altering themselves. My investigations focus on knowledge transfer and innovation related firm responses with an emphasis on firms' especially, Multinational Enterprises' (MNEs) market strategies such as ownership, governance and location choices and their non-market strategies such as political networking and stakeholder management. I'm particularly interested in emerging countries and the changing institutional environment in those contexts. To study changes occurring in different speeds and varying firm responses to them, I have hand-collected longitudinal datasets for different industries and employed both qualitative and quantitative methodologies: my datasets covers both moderately-dynamic industries such as multinational construction and retailing and as well as more knowledge-intensive industries such as multinational pharmaceutical, electronics and computer & software industries.

Chapter 1: MNE Legitimacy in the Eyes of the People: Insights from Libya about Surviving Association with an Overthrown Regime

In the first chapter, I investigate how firms respond to changes that are less-anticipated and takes place in a rapid fashion. Differentiating between the learning that MNEs accumulate at the host-countries and related learning they transfer from similar locations, this paper is built upon and extend theories about how MNEs, cope with institutional voids and transitions in relation to their political connections, corporate social responsibility strategies and interactions with stakeholders in the emerging countries. In order to do so, I conducted an in-depth qualitative study on how different MNEs with different interaction levels to the Gaddafi Regime, society, tribes and the

new government in Libya were affected by the Arab Spring. In this paper, using the Arab Spring as a natural experiment and employing Qualitative Comparative Analysis (QCA) and Fuzzy-set methodology, we build new theory on how MNEs can survive and even thrive during times of fast institutional transitions. We introduce “the legitimacy of the government” as an alternative measure of host-country political environment assessment and suggest that MNEs that deepened, broadened and expanded their political connections and strategies to multiple political actors and complemented them with CSR related activities fare better major institutional changes at the host countries. In addition, the results suggest that host-country only specific learning can lock-in MNEs not to see the changing “tea leaves” if they don’t complement it with their recent related experiences from their operations other countries.

Chapter 2: The Effect of Different Post-Entry Experiences on Changing Market Entry Choices

The second chapter focuses on post-entry operations of multinational retail firms that are required to offer a standardized service for an effective knowledge redeploying, but also need to recombine their HQ knowledge with the knowledge that the subsidiaries possess, to ensure adaptation to the local conditions at the same time. The change, now being the multiple uncertainties related with multinational retail chains’ internationalization into different locations, I first analyze how these firms decide on efficient firm boundaries and positioning after their entry into the host countries, and then investigate effects of these post-entry choices on their performance at the host-countries. Constructing a novel data-set of MNEs post-entry commitments in the host countries, my study reviews MNEs’ behavior after they have entered a foreign country and individually tracks their alteration of its ownership and retail format changes over

time within that country starting from 1975 and until 2013. This paper provides a more process-based understanding of MNEs' choices and strategies at the host countries, which extends the scant literature on mode-dynamics. The empirical results show that; MNEs are more likely to change their governance modes after the negative initial performance rather than after the positive initial performance, however, they tend to act completely in the reverse fashion for their decisions regarding changing their initial format choices at post-entry. I also show that the MNEs that change these initial market entry choices regardless of the initial performance have higher probability of survival at the host countries at post-entry, controlling for the dissimilarity between the home and the host countries and after taking into consideration of the possible selection effect of initial market entry decisions.

Chapter 3: Differential Effects of Local, Foreign Firms and Supra-National Institutions on the Pace of Institutional Change in Developing Countries

In the third chapter, I track changes in local innovation process and IP regime at the same time in the knowledge intensive patent areas such as pharmaceuticals, computer, software and electronics in developing countries. My focus is on Trade Related Intellectual Property Standards (TRIPS) agreement which was signed between developed and developing countries that made it compulsory in emerging countries the protection of product patents along with the process patents. Developing countries were given a 10-year allowance until January 1, 2005, in order to bring their patent system into line with TRIPS obligations as well as other flexibilities.

Interestingly, while some of the developing countries such as India used these flexibilities and waited until the end of the 10-year allowance, some countries such as Brazil, Korea and Turkey ratified the TRIPS agreement and put the new regulations into action right away. We explain the variation in developing countries' rate of TRIPS

compliance by new institutionalism and co-evolutionary perspectives, by presenting a framework that shows effects of different actors within innovation systems on different trajectory and rates of institutional change. The results indicate that higher composition of local firms result in slower change of the IP Regime in developing countries, while higher the Advanced Country Multinationals, faster the change. I also find that supranational institutions such as IMF moderate this relationship.

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CHAPTER 1

MNE LEGITIMACY IN THE EYES OF THE PEOPLE: INSIGHTS FROM LIBYA ABOUT SUCCESSFUL HEDGING ACTIVITIES IN UNCERTAIN POLITICAL ENVIRONMENTS

ABSTRACT

Using the before-after natural experiment occasioned by the Arab Spring in Libya, we explore the effects on firm survival of market and nonmarket activity directed to political and social actors. Although construction MNEs in Libya had to cultivate strong ties to the Qadhafi government to succeed during his forty years of rule, those that also invested in social-benefit projects and in social ties with *non*-Qadhafi-family families earned a broad-based legitimacy that helped them survive Qadhafi's overthrow. More generally, our findings suggest that investing in attaining legitimacy in the eyes of society improves MNE prospects in uncertain institutional and political contexts.

Keywords

Political risk. Legitimacy. Social ties. Libya. Natural experiment. Political ties.

1.1 Introduction

The political risk literature suggests that understanding and trying to shape government policies towards MNEs in general and towards any given firm will contribute to that firm's long-term success in a host country (Henisz & Zelner, 2005, Oliver, 1991). In particular, paying attention to the "determinants of legitimacy in a given society" seems to be critical to understanding the social and political factors at play and so to predicting future policies (Henisz & Zelner, 2012: 47). It is, however, extraordinarily difficult to perceive and understand the underlying forces that contribute to the legitimacy of policies or even governments in emerging countries characterized by underdeveloped or uncertain institutional contexts, volatile politics and the possibility of macro political shocks such as violent conflict (Fitzpatrick, 1983, Getz & Oetzel, 2009, Khanna & Palepu, 2000).

Adding to the complexity is the role of firms in unfolding political sagas. Developing close political ties with government can help MNEs navigate uncertain institutional and political environments (Cuervo-Cazurra, 2006, Sun, Mellahi, & Thun, 2010). The problem is that the very ties that aid navigation in uncertain environments also increase the risk that the firm will suffer from association with an unpopular government (Sun, Mellahi, & Wright, 2012), especially if that government loses power and/or legitimacy with society at large (Bucheli & Salvaj, 2013, Leuz & Oberholzer-Gee, 2006). Close association with a fallen government can threaten a firm's own legitimacy, license to operate and assets (Getz & Oetzel, 2009, Leuz & Oberholzer-Gee, 2006, Siegel, 2007). The risk of guilt by association is particularly acute when governments are autocratic and institutions have developed little legitimacy beyond their association with the ruling regime (Bucheli & Kim, 2012, Henisz & Zelner, 2004). Firms that operate in such contexts, whether by choice

or accidents of history, face the impossible dilemma of risking the government's ire by building relationships with opponents or eroding the firm's legitimacy in the eyes of a broad swath of society by maintaining cozy ties with the ruling elite (Bucheli & Salvaj, 2013).

Recognizing this challenge, Sun and colleagues have recently called for more exploration into how firms "manage relationships between rival political groups in a politically unstable regime," especially when facing political upheaval (Sun, Mellahi, & Wright, 2012: 80). In one of the few studies to address the challenge directly, Doh & Ramamurti (2003: 349) suggest that firms engaged in infrastructure projects in volatile country contexts "should consider ... a proactive approach to attaining and maintaining social legitimacy as a way to protect against risks." In this paper, we follow these hints and explore what actions might help MNEs active in volatile institutional and political contexts hedge against ongoing uncertainty and risk. In particular, we explore what firm behaviors might generate enough firm legitimacy to maintain a license to operate despite uncertainty about the future of the regime with which the firm has been associated.

We explore this question by using the abrupt fall of the long-established Qadhafi regime in Libya as a before-after natural experiment that allows one to discern the differential impact of MNEs' pre-overthrow market and non-market behaviors on their performance during and after the transition. A before-after natural experiment is useful because it allows for the isolation of confounding factors and the identification of possible causal relationships that can then be generalized beyond the specific context of the experiment (Remler & Van Ryzin, 2011). Libya is an appropriate setting because its social and political structure had been radically simplified by years of autocratic rule, because it

was stable for more than forty years, and because the overthrow of Qadhafi was as surprising as it was complete. Concentrating on construction firms sharpens the focus on legitimacy because success in securing contracts depended on close relations with the Qadhafi regime. Finally, limiting the study to Turkish multinational construction firms removes industry and home country variation as confounding factors.

Our analysis indicates that while close ties to the Qadhafi regime were necessary to do business in Libya before the transition, the MNEs that survived the transition were those that engaged successfully in a delicate dance in which they hedged their relationship to the Qadhafis by investing in projects and relationships that earned legitimacy in the eyes of non-state, non-Qadhafi-family actors. Our findings provide insight into the specific kinds of market (such as work on specific projects) and nonmarket (such as lobbying or relationship-building) behaviors (Baron, 2001, Lawton, McGuire, & Rajwani, 2013) that bolster broad-based firm legitimacy and so resilience in the face of abrupt regime change. More generally, these results contribute to the political risk, political behavior and political ties literatures insights into how legitimacy-building efforts directed towards the social sector can hedge the risks of operating in emerging and transitional contexts marked by weak institutions, often autocratic regimes and uncertain futures (Bucheli & Kim, 2012). Further, our findings contribute to new institutionalism theory concrete evidence of the importance of material as well as symbolic activity (Thornton, Ocasio, & Lounsbury, 2012: 10-11) to the generation and maintenance of legitimacy in the eyes of skeptical and disparate stakeholders (Bitektine, 2011, Scherer, Palazzo, & Seidl, 2013). Finally, our results add to international business theory a social-sector-based path to MNE legitimacy that complements, and when a government's legitimacy is called into question, may

substitute for, Boddewyn and Brewer's government-based path to firm legitimacy (1994: 121).

In the next section of this paper, we draw on the interconnected political risk, political behavior and political ties literatures to describe the political behavior dilemma faced by MNEs operating in volatile, institutionally weak environments in which underlying determinants of legitimacy are opaque and the risk of abrupt regime change palpable. We then turn to the new institutionalism literature to identify the factors that might help MNEs generate and maintain enough firm legitimacy to reduce the damage of being associated with a government that loses power and/or legitimacy in the eyes of society. In the third section, we describe the before-after natural experiment that we use to explore what actions and factors might help firms survive significant political and institutional change. The fourth section follows the fates of eight Turkish construction MNEs during and after the overthrow of the Qadhafi regime. Having set the theoretical and experimental context, in the fifth section, we weave back and forth between theory and the experience of the Turkish MNEs to construct a model of a social sector path to generating broad-based legitimacy, and so a resilient license to operate. Lastly, we conclude with implications for theory, research and managerial action.

1.2 Background: The Dilemma of Corporate Political Engagement in Volatile

Contexts

We start this section with insights from the political risk literature concerning the factors that affect firm success in uncertain institutional settings. We then describe how developing close ties with the ruling regime in underdeveloped and volatile settings can both increase

profits and threaten MNEs' legitimacy and so their long-term license to stay should the government lose power or legitimacy. Finally, we look to the literature at the intersection of new institutionalism and political risk for insight into how firms develop and maintain firm legitimacy and the license to stay. Throughout, we highlight questions to examine during the before-after experiment.

1.2.1 The Mixed Blessing of Political Engagement in Contexts Fraught with Political Risk

The well-established political risk literature explores the impact on MNE performance of government actions and policies, political instability, and/or lack of institutional protections (Henisz, 2002, Howell & Chaddick, 1994, Miller, 1992). From early on, scholars have framed the relationship between MNEs and host governments as a bargaining process in which both parties strive to extract as much value as possible from firm investment (Vernon, 1971), but with governments usually able to use levers ranging from the threat of expropriation to subtler means such as regulation and enforcement to ensure that, over time, firms support government objectives (Henisz & Zelner, 2005, Makhija, 1993, Vachani, 1995). Subsequent work has unpacked the factors affecting the bargaining effectiveness of both MNEs and host countries, showing, for example, that firms' susceptibility to government influence is related to industry type, ownership modes, capital structure, contract enforcement, the intellectual property regime, and the fit between firm resources and institutional contexts (Brouthers, 2002, Delios & Henisz, 2000, Delios & Henisz, 2003, Kesternich & Schnitzer, 2010, Oxley, 1999). For its part, the strength of governments' bargaining position is affected by policy goals; the relative and changing

needs for MNE-provided technology, capital and jobs; and pressures exerted by competing formal and informal interests groups within the country (Henisz & Zelner, 2005, Henisz & Zelner, 2010, Kobrin, 1984, Oliver, 1991, Opp, 2012). Firms that are successful in a particular country are those that become well attuned to the push and pull of political forces within that country (Hadjikhani, Lee, & Ghauri, 2008, Henisz & Zelner, 2005).

Because, on average, increased political risk is associated with reduced investment (Feinberg & Gupta, 2009) and the risk of dramatic losses such as through expropriation (Kobrin, 1984), one approach to political risk has been to focus on the problem of measuring the intensity of political risk facing MNEs in specific countries (Howell & Chaddick, 1994). Many such measures have been shown to be poor predictors of future political risk (Howell & Chaddick, 1994, Oetzel, Bettis, & Zenner, 2001), in part because they remain static assessments based on historical data, rather than attempts to forecast future events (Howell, 2014), although recent work on higher-than-usual ROA in a country (Click, 2005) and country political risk spreads based on dollar debt and bond yield spreads (Bekaert, Harvey, Lundblad, & Siegel, 2013) promise better predictions of future political risk. Despite these improvements, these models do not – and perhaps cannot – encompass true uncertainty – those discontinuous, episodic, and often high-impact risks such as natural disasters, terrorist attacks and radical realignments of power like those during the Arab Spring (Bekaert, Harvey, Lundblad, & Siegel, 2013, Czinkota, Knight, Liesch, & Steen, 2010, Oetzel & Oh, 2014).

Political risk in general, and discontinuous political risk in particular, may be especially hard to assess in countries in which institutional arrangements fall short of providing adequate and predictable support for business transactions and instead allow governments

to exercise volatile control over regulation, resources, information and the license to operate (Khanna & Palepu, 2000, Luo, 2006, North, 1990). In such circumstances, policy implementation is often affected by pervasive and corrosive corruption (Doh, Rodriguez, Uhlenbruck, Collins, & Eden, 2003), and the institutional rules of the game are subject to challenge from various actors outside of the ruling government (Acemoglu & Robinson, 2006, Bucheli & Kim, 2012). Unsurprisingly, many studies of political risk simply advise MNEs to avoid entry into contexts with weak or uncertain institutions (Meyer, Estrin, Bhaumik, & Peng, 2009, Rodriguez, Uhlenbruck, & Eden, 2005). At the same time, the lure of high return on investment for firms that can manage the uncertainty (Click, 2005, Oetzel & Oh, 2014) and unexpected changes in context conspire to ensure that many MNEs do operate in such contexts, and so face the pressing question of how to cope with uncertainty about both the political and institutional rules of the game (Hoskisson, Eden, Lau, & Wright, 2000, Makhija & Stewart, 2002), including, at the extreme, the risk of violent conflict or revolution (Henisz, Mansfield, & Von Glinow, 2010). Given both the unpredictability and likelihood of such events, how can firms operating in institutionally and politically uncertain contexts hedge against political risk that they can expect, at some point, but not predict?

One way to cope with discontinuous political risk and uncertainty is to try to shape the political environment to create a more favorable political, institutional and economic context (Alon, Gurumoorthy, Mitchell, & Steen, 2006, Boddewyn & Brewer, 1994, Oliver & Holzinger, 2008). There are many studies that detail the strategies and tactics that MNEs employ to influence the political context in host countries with relatively stable institutions (Hillman, 2003, Hillman & Hitt, 1999, Hillman, Keim, & Schuler, 2004, Hillman & Wan,

2005, Holtbrügge, Berg, & Puck, 2007, Rizopoulos & Sergakis, 2010), but relatively few studies that document how MNEs manage the daunting task of shaping policies, governments and institutions in the multi-faceted and uncertain political and institutional landscape of emerging and transitional countries (Bucheli & Kim, 2012, Bucheli & Salvaj, 2013, Cuervo-Cazurra & Genc, 2008). Still, there is evidence that suggests that MNEs operating in weak or uncertain institutional environments would do well to adopt a relational posture towards the government (Hillman & Hitt, 1999) and develop deep and close ties with leading governmental figures and entities (Sun, Mellahi, & Thun, 2010, Zhu & Chung, 2014). Such social and political ties – those “boundary-spanning personal and institutional linkages between MNEs and constituent parts of public authorities” (Sun, Mellahi, & Wright, 2012: 68) – are the conduits for the information, financial incentives and constituency building that are in turn the mechanisms through which political influence is wielded (Hillman & Hitt, 1999, Peng & Luo, 2000). In institutionally and politically uncertain contexts, embedding the firm within the local power structure has been shown to reduce the liability of foreignness (Figueira-de-Lemos, Johanson, & Vahlne, 2011, Johanson & Vahlne, 2009), mitigate various political and contractual risks (Delios & Henisz, 2003), and improve access to resources, information and political favors (Frynas, Mellahi, & Pigman, 2006, Peng & Luo, 2000, Peng, Wang, & Jiang, 2008). Specific to our context, the nurturing of close political ties has been recommended in the Middle East and North Africa, for all of the above reasons but also as a buffer to the wide-spread popular skepticism concerning the intentions of MNEs in emerging countries (Mellahi, Demirbag, & Riddle, 2011).

The danger with the relational posture and the building of deep and close ties to the government is that the benefits of such political embeddedness can evaporate, or even become a liability, if the political context shifts suddenly (Siegel, 2007). Part of the problem is that the reliance on a web of political ties heightens the risk of becoming dependent on, and beholden to, political actors (Sun, Mellahi, & Thun, 2010), actors who may arbitrarily increase their demands for support (Kivleniece & Quelin, 2012) or even be tossed out of office when political regimes change. Worse, close association with the host government can be devastating to the firm's agreements and legitimacy if its political patrons suffer a political setback (Leuz & Oberholzer-Gee, 2006, Siegel, 2007), or if civil war or rebellion erodes the power and authority of a given government (Getz & Oetzel, 2009). Concretely, when politicians, regimes or parties lose power, they can no longer provides benefits to MNEs (Fisman, 2001, Johnson & Mitton, 2003); as instability rises, even corrupt practices lose their effectiveness because there is increasing doubt about whether those paid will be able to deliver on their promises of influence (Fredriksson & Svensson, 2003). At the extreme, political connections can become liabilities if a new government retaliates against MNEs allied with the fallen government (Bucheli & Salvaj, 2013, Dieleman & Sachs, 2008, Leuz & Oberholzer-Gee, 2006).

In sum, firms operating in uncertain political and institutional settings face the twin problems of preparing for discontinuous risk and determining how close to draw to the ruling regime. This introduces profound uncertainty into MNEs' choices about with whom to engage (Henisz & Zelner, 2005, Roth & Kostova, 2003, Siegel, 2007), as managers try to handicap which political faction and set of rules might prevail (Chen, Ding, & Kim, 2010, Getz & Oetzel, 2009, Peng, 2003). As lucrative as the correct choice of patron could

be, the wrong choice could well threaten the MNE's license to operate and very existence in the host country. How can an MNE protect itself from the existential threat of backing the wrong side in the relatively likely, but unpredictable, event of political upheaval?

1.2.2 Factors Affecting the Struggle for Firm Legitimacy in Uncertain Institutional Contexts

A firm's ability to earn and maintain legitimacy and so a "license to stay" (Boddeyn, 1995, Steger, 2003) has been shown to be a threshold condition for firm success in a host country. In the international business literature, firm legitimacy has often been interpreted as conformance with local values and norms, support of national goals, and especially the seeking of a "derivative 'seal of approval'" through association with the established government (Boddeyn & Brewer, 1994: 135). However, in recognition of the broader sociopolitical sources of risk (Frynas & Mellahi, 2003), more recent work has begun to highlight the importance of broadening the understanding of the sources of legitimacy to include non-governmental social actors including advocacy groups, community groups, consumers, labor, nonprofits and the media (Dahan, Doh, Oetzel, & Yaziji, 2010, Gifford & Kestler, 2008, Henisz, Dorobantu, & Nartey, 2014, Marano & Tashman, 2012, Windsor, 2007). The idea is that, "managers who understand the *determinants of legitimacy* in a given society are better able to assess which existing and potential policies are likely to survive than those [managers] who focus exclusively on the configuration of economic influences and formal political institutions" (Henisz & Zelner, 2012: 47, *emphasis added*).

We understand legitimacy as the "generalized perception or assumption that the actions of an entity are desirable, proper, or appropriate within some socially constructed system

of norms, values, beliefs, and definitions” (Suchman, 1995: 574). Cognitive, moral and practical legitimacy are the three main types of legitimacy that affect a firm’s license to stay (Aldrich & Fiol, 1994, Bitektine, 2011, Claasen & Roloff, 2012, Scherer, Palazzo, & Seidl, 2013, Suchman, 1995). Cognitive legitimacy arises when firms fit into the local landscape without question: A firm is perceived as legitimate when its existence is taken for granted. Pragmatic legitimacy derives from meeting the needs of stakeholders: A firm is perceived as legitimate by certain parties if the firm’s activities align with the parties’ self-interest and expectations. Moral legitimacy depends on evaluation of a firm’s benefits to society given regulatory, cultural and social norms: A firm is perceived as legitimate if observers agree that its outputs, activities and leadership live up to local norms of proper behavior and benefit certain social groups or even the society as a whole. Importantly, both pragmatic and moral legitimacy must be continually earned and reaffirmed in an ongoing dialog between firms, stakeholders and social actors (Suddaby & Greenwood, 2005). When political arrangements and institutions are weak, emerging or otherwise in flux, cognitive legitimacy dissipates (Henisz & Zelner, 2005), and pragmatic and moral legitimacy become subject to ever more active, ongoing and conscious evaluation by stakeholders and social actors (Bitektine, 2011, Palazzo & Scherer, 2006). This puts MNEs in the uncomfortable position of engaging with diverse, skeptical and quite possibly hostile stakeholders.

In response, MNEs actively engage in shaping practice and symbols to try to affect both perceptions of what is legitimate and how well their firms’ fit the perception of legitimacy (Kostova, Roth, & Dacin, 2008, Patriotta, Gond, & Schultz, 2011, Thornton, Ocasio, & Lounsbury, 2012, Zilber, 2006). For example, Hadjikhani, Lee & Ghauri (2008)

argue that MNEs can improve firm legitimacy directly through investments in better products or services or through the lobbying of government; they can also increase firm legitimacy indirectly by trying to influence market demand or government choices through the mobilization of sociopolitical actors such as environmental and community groups (Henisz, Dorobantu, & Nartey, 2014) and the media (Hadjikhani & Ghauri, 2001; see also Hillman and Hitt, 1999 for the notion of constituency building).

In uncertain institutional and political contexts, such efforts to build and maintain legitimacy in the eyes of multiple actors becomes acutely challenging, especially when the legitimacy of both government institutions and associated firms are called into question and when formal stakeholder voices such as NGOs and the media have been muzzled, leaving it unclear to whom the MNE should address in any attempt to maintain or rebuild legitimacy. The question becomes how a firm can earn or maintain firm legitimacy when the “determinants of legitimacy in a given society” are fundamentally unclear, or, worse, change suddenly and completely. The new institutionalism literature suggests that factors to consider include attention to the sociopolitical actors that influence politics and policy making; relationship building with and lobbying of actors both inside and outside of the government; and product or service type and quality. We turn now to the natural experiment to explore whether and how such factors help firms hedge their bets against discontinuous and unpredictable political risks.

1.3 Methodology

To explore the factors that contribute to firm survival in uncertain and volatile contexts, we make use of the natural experiment afforded by the unexpected overthrow of the

Qadhafi regime during the 2011 Arab Spring. Natural experiments offer insights into the causal relations between variables and so can provide a firm foundation for theory development; the goal is to illuminate and extend theory, not to test variables by generalizing to a population (Remler & Van Ryzin, 2011, Yin, 2002). To qualify as a natural experiment, the initial state must be clearly delineated, the treatment must be exogenous, and as many variables as possible must be held constant (Kogut & Zander, 2000). By studying one set of MNEs originating in the same country and operating in one government-influenced industry before, during and after the overthrow of the Qadhafi regime, we employed a single-group, before-after experimental design (Remler & Van Ryzin, 2011) to isolate critical elements and combination of elements related to firm survival despite a fundamental shift in political arrangements, institutional context and the underlying determinants of legitimacy.

1.3.1 Turkish Construction MNEs in Libya during the Arab Spring: A Before-After

Natural Experiment

Our study group consisted of 8 Turkish construction MNEs operating in Libya as of January 2011. The initial conditions included the firms' location in the country, project mix and choice of political posture *vis a vis* the Qadhafi family. The treatment was the startling, Arab-Spring-inspired overthrow of the more than forty-year-old Qadhafi regime that took place between 16 February 2011 and 20 October 2011. The results examined were the impact on the MNEs' operations and future prospects both during the transition and in the period immediately after Qadhafi's ouster. We used June 2012 as the endpoint for

collecting results because by then the National Transitional Council had consolidated control and business activity had remerged.

Libya in 2011 provided a near perfect setting for a study of the impact of abrupt regime change in a weak institutional context. First, under Qadhafi, Libya's institutions, including its tribes, were systematically eroded, leaving huge institutional voids filled only by Qadhafi and local families (Hweio, 2012, Khanna & Palepu, 2000). Second, Qadhafi had been so entrenched for so long that no one predicted his downfall. And third, the overthrow of Qadhafi was cataclysmic and quickly resolved (or so it seemed when we collected the initial data in 2011 and 2012).

We chose construction MNEs because they relied on relationships with the government to win contracts and approvals. To be successful in construction in Qadhafi's Libya, *all* MNEs had to work in some way with the Qadhafi family. "If you want to do construction business in Libya, you had to engage in some relationship with the Qadhafi Government..." (Specialist, Turkish Contractors Association, 2011). Despite this reality, during and after the overthrow, some MNEs were able to escape the taint of close association with the Qadhafi family, while others were punished for the same kinds of ties to the Qadhafis. Why some MNEs did well and some suffered, despite starting with similarly close ties with the Qadhafi regime, is at the heart of the experiment.

We chose Turkish construction MNEs in particular because we could, through personal connections in Turkey, secure access to data from individual MNEs, the Turkish Contractors Association and the government. Less opportunistically, the actions and fates of Turkish construction MNEs promised to be instructive because of their long, profitable experience in Libya, their close ties with the Qadhafi government (Country expert, Turkish

Ministry of Economy, 2011), and the variance in how the MNEs fared during and after the overthrow of the Qadhafi government. While some MNEs suffered looting or worse, others were protected by local, non-state actors; and while some MNEs were invited by the transitional government to continue their projects, some were not (Turkey MFA Report, 2011). Further, by selecting MNEs from one industry and one home country, our design held constant both country-level effects of tolerance for risk and industry-level effects of experience and norms (Alon & Herbert, 2009, Hillman, Keim, & Schuler, 2004).

As for the selection of particular MNEs, we were purposeful in our approach and looked for MNEs that exhibited behaviors or choices that theory suggested might be important (Eisenhardt & Graebner, 2007, Yin, 2002). We tried to find as much similarity in firm size, structure, and the like, and as much variation as possible in behavior so that we could use the structure of the natural experiment to highlight possible causal relationships between pre-treatment states and post-treatment outcomes.

TABLE 1.1 Eight Turkish Construction MNEs Active in Libya, 2011-2012

Firm	Ownership	Year Est.	Size Employees	Global Reach Nations	Project Expertise*	Year Entered Libya
DEY	Private	1997	1,000	4	Superstructure	2008
GUR	Private	1958	5,500	10	Infrastructure, superstructure	2007
REL	Private	2007	1,800	2	Superstructure	2007
REN	Private	1993	6,200	10	Infrastructure, superstructure	2007
SEM	Private	2000	6,000	5	Superstructure	2009
TEK	Public	1957	10,680	13	Infrastructure, superstructure	2006
YAS	Private	1962	2,000	4	Superstructure	1979
YUK	Private	1963	9,000	11	Infrastructure, superstructure	2006

* **Infrastructure:** Railroad, bridges, roads, ports. **Superstructure:** Industrial plants, universities, hospitals, hotels, housing.

DEY Profile

Established in 1997 in Ankara. Experienced in mass-housing projects. The first project abroad was in Libya in 2008, then expanded to Georgia, Iraq and Germany. The project was construction of 2200 villas in Benghazi under a JV with a Libyan company. Company hired people who had worked in the first companies that entered to Libya such as STFA and Mesa.

GUR Profile

Established in 1958 in Ankara. First international project was in 1981 – Germany. Starting with 1990s the company expanded to Iraq, Dubai, Kazakhstan, Romania, Ukraine, Saudi Arabia, Russia and Syria. Entered to Libya in 1985. Exited in 1988. Re-entered in 2007. First project: The Tripoli Park, administered by ODAC. Also working on a hospital and university in Libya.

REL Profile

Established in 2007, with 35% partnership ownership from REN. Was involved with constructing a shopping mall in Tripoli. There were 4 other projects totaling \$450 million that were in the tender phase as the Arab Spring began. The company also reported that they were expecting to bid to another \$500 million worth of projects in 2011.

REN Profile

Established in 1993 in Ankara Turkey. First international experience in Russia. Next Ukraine, then to Turkic Countries (Turkmenistan, Kazakhstan, Uzbekistan). After 2005, the company expanded to Qatar, Saudi Arabia, Azerbaijan and Libya. 69th in ENR (Engineering News Records) in 2011. Bid projects under ODAC and LIDCO. The other potential clients were listed as Roads & Bridges Authority and Public Utility Ministry. As of 2011, their bids for 11 additional projects were under review.

SEM Profile

Established in 2000 in Istanbul. Entered to Libya in 2009. Projects in Kazakhstan, Russia, Ukraine, Croatia, UAE and Libya. Main revenue source: projects in Kazakhstan. 142nd in ENR in 2011. Had completed construction of 54 VIP villas in Sirte, Libya in 2010. Projects underway in 2011 were new faculty buildings for Garyounis University and a luxury apartment complex in Benghazi.

TEK Profile

Established in 1957 in Istanbul, Turkey; became a public firm in 2007. In 1990s, entered Russia, Azerbaijan, Germany, Kazakhstan, Uzbekistan, Georgia. In 2000s, started doing projects in Bulgaria, Morocco, and Qatar, and in 2011, in Oman. 88th in ENR in 2011. Entered Libya in 2006 with 400 km pipeline project between Sadir and Kudra (East of Benghazi). Entered to Libya under a JV with TML, an experienced Turkish construction firm in Libya. TML was founded by an engineer who had been working for STFA (the first Turkish firm in Libya).

YAS Profile

Established in 1962 in Ankara. First international project was in Libya in 1979. Then moved to Russia, Azerbaijan, and Saudi Arabia. Last included in ENR “Top 225 International Contractors” in 2010. Main projects at the time of the Arab Spring were a summer residence and guest house for the Prime Ministry and renovations at the university.

YUK Profile

Established in 1963 in Ankara. Built important infrastructure projects covering transportation, energy, environmental and industrial projects in Turkey. Expanded its operations to Saudi Arabia in 1984 and later to other international locations including Kazakhstan, Afghanistan, Uzbekistan, Georgia, Ukraine, Romania, Dubai, Qatar, Jordan, Libya and Northern Iraq. 85th in ENR in 2011. Entered to Libya in 2006. Started with 3 projects; 2 of them roads. The main contractors were ODAC for their Tripoli University project; they had also done road project for General Roads and Bridges Authority/Transport Projects Board

As summarized in Table 1.1, the eight MNEs studied were mostly private and had, with one exception, entered Libya right after the 2006 diplomatic accord between Turkey and Libya. They varied in age, size, and to a lesser degree, areas of construction expertise. All employed at least 1000 people and had, with one exception, decades of experience as construction contractors. Further, all had significant international construction experience, often in challenging markets such as the countries of Central Asia, Russia, the Middle East and North Africa.

1.3.2 Data Collection

To ensure a similar sequence and format of questions for all interviews (Yin, 2002), we developed a case study protocol and amended this with the help of specialists within the Ministry of Economy and the Contractors Association. The protocol included the purpose of and rationale for the research, the research question and interview questions. We started with introductions to nine MNEs but dropped one due to a lack of reliable access to senior executives. We collected data on eight MNEs through 19 semi-structured, in-depth interviews: Six with Turkish government country experts, four with the experts from the Turkish Contractors Association, and nine with senior executives from the MNEs. All initial interviews were conducted between December 2011 and June 2012 when the experiences described were still fresh in the minds of the interviewees.¹ The interviews averaged two hours in length. Later, during the winter of 2013-2014, we conducted follow-up interviews with 6 of the original interviewees. The goal of these interviews was to confirm or adjust our earlier impressions and to ask additional questions about specific

details that had become more important during the analysis of the original data. These interviews averaged 90 minutes in length and brought the total number of interviews to 25.

We chose to interview senior executives because we were interested in their thinking about whether, when and how to interact with the Qadhafi government and other actors in Libya; we tried to reduce informant bias by framing the interview as an exploration of their experience during the overthrow of Qadhafi and by avoiding leading questions or theoretically loaded language. We interviewed experts in the government and the Turkish Contractors Association both because we valued their knowledge of situation on the ground and because we thought that their assessments of firm behaviors would be less subject to rationalization or other ex-post attempts, whether conscious or not, to place a particular firm or decision in the best possible light (Miles & Huberman, 1994).

Finally, to further increase the reliability of the data, we triangulated (Baxter & Jack, 2008, Eisenhardt, 1989, Yin, 2002) the interviews with information from the Turkish Contractors Association, data and analysis from the Turkish Ministries of Foreign Affairs and Economy, and news reports from the online components of Al Jazeera (Qatar), CNN (USA), Hurriyet (Turkey) and Milliyet (Turkey). In all, we consulted 10 internal reports and more than 65 links, totaling approximately 300 pages of reportage and analysis.

1.3.3 Data Analysis

As we completed the interviews, we translated and transcribed them as interview records.² To increase our sensitivity to possible causal relationships, we also sought to put the interviews in a broader context (Welch, Piekkari, Plakoyiannaki, & Paavilainen-Mäntymäki, 2011) by thinking about the responses in light of data from secondary sources

and constructing an event history for each firm to provide the basis for further interpretation (Gerring, 2007).

With this data in hand, we then applied open and axial coding to the event narratives and interview notes to identify emergent themes and categories (Corbin & Strauss, 1990, Glaser & Strauss, 1967). Periodically, we attempted to organize our data into tables and diagrams that expressed critical relationships. Such attempts at visualization led to useful insights, including, for example, the relationship between project type and post-treatment performance. The visualizations also led us to revisit our interview notes and to collect additional primary and secondary data to explore possible new constructs or relationships between constructs (Burgelman, 2011). Finally, as we prepared this narrative, we moved back and forth between theory, categories, visualizations and the original data until we were able to articulate as specific propositions a series of insights that were at once consistent with the experience on the ground and useful for refining theory (Birkinshaw, Brannen, & Tung, 2011, Eisenhardt & Graebner, 2007).

1.3.4 Boolean Truth Tables Exploration of Alternative Explanations

Although the before-after natural experimental design supports insight into causal relationships, the tremendous complexity of social, political and economic phenomena makes it possible to miss alternative explanations such as path dependency and various exogenous variables (Cook, Campbell, & Day, 1979, Remler & Van Ryzin, 2011). Given both the likelihood that additional factors shaped the trajectories of our eight MNEs and the limitations of a small data set, we employed Comparative Boolean Analysis, specifically Truth Tables, to bring additional logical rigor to our examination of possible

causal relationships (Lieberson, 1991, Ragin, 1987). Comparative Boolean Analysis is used for identifying combinations of casual conditions associated with various outcomes and is particularly useful for identifying patterns that might be missed by simply examining cases (Ragin, 1994). Practically, we proceeded by brainstorming a list of firm attributes and path dependencies that could conceivably affect the fate of the MNEs under study and then subjected these to Boolean addition and logical minimization to identify the specific configurations of factors associated with each outcomes. We then compared the results with our previous conclusions to see what additional insight they provided.

1.4 Results: The Factors That Influenced Firm Survival After The Overthrow Of Qadhafi

In this section, we begin with a description of the economic and political realities that obtained in Libya before, during and after the overthrow of Qadhafi. We then hone in on the focal MNEs and their position and postures as of January 2011. Next, we report the fate of the MNEs during the treatment period. We finish with a recounting of results as of June 2012, the endpoint of the experiment.

1.4.1 Setting: Libya Before and After Qadhafi

Although it includes regions that trace their identity back to the Ottomans or before, Libya is a young state, formed in the aftermath of World War II with the support of Great Britain. In 1951, King Idris became the first leader of the modern state until deposed by Colonel Moammer al-Qadhafi in 1962. Qadhafi centralized control and undercut the legal authority of local tribes, but also relied on tribal loyalties and informal structures to reinforce his

control, often substituting members of one tribe for another in a decades-long game of divide and conquer (Anderson, 1990, Lacher, 2011). Further, Qadhafi changed the rules and organizational arrangements constantly, thus preventing any solidity in governmental structures (El-Kikhia, 1997). Unsurprisingly, doing business in Libya always featured an element of uncertainty: “You couldn’t guess what Qadhafi’s next move would be; one day he could be good, the next day he could seize all of your assets” (YAS, 2011).

The results were remarkably weak institutions coupled with strong state intervention in every aspect of the economy and society (Hweio, 2012). “The only encompassing ‘institution’ in Libya was the colonel himself and his clutch of advisors, many drawn from his family. Subordinate institutions were entangled in overlapping and contradictory networks with no common ordering principle or chain of authority beyond Qadhafi’s presence at the top of every heap” (Boduszyński & Pickard, 2013: 87). Come the 2011 revolution, what state institutions there were, including the army, crumbled, leaving a dearth of institutions capable of managing the crisis (Lacher, 2011). During the crisis, individuals turned for security to their extended families and what was left of the traditional tribes (Hweio, 2012).

In Libya, as in many countries, the tribal clan – “an informal identity network based on kin...bonds” – has long been a critical component of the social structure and a source of resistance to the central government (Collins, 2004: 224, Myers, 2013). Indeed, despite Qadhafi’s manipulation, local tribes remained influential outside of Tripoli, especially in the southern deserts and in the east in Benghazi, Sirte and Imsaad (Anderson, 2011, Lacher, 2011). At a more grassroots level, extended families were important as official actors in the tribal structure and as informal social actors playing roles somewhat similar to those

played by NGOs, charities and activist groups in other political systems (Anderson, 1990; Hweio, 2012; Turkish Ministry of Economy, 2011). Before and after the overthrow of Qadhafi, Libya's social sector was local, interpersonal and familial – resting on connections among family, friends and classmates (Boduszyński & Pickard, 2013).

Consistent with literature on countries supported by natural wealth extraction (O'Higgins, 2006), Qadhafi was able to maintain his power because he was able to use oil money to improve living standards, change institutional structures and rules at will, and buy the support of tribes and families as needed (Myers, 2013). Indeed, although the widespread corruption in favor of a few families during the reign of King Idris contributed mightily to Qadhafi's coup (Anderson, 1990), Libya's habit of corruption continued through the Qadhafi years. While, on the one hand, "Qadhafi was very cautious about corruption and from time to time penalized MNEs [for corruption]" (REN, 2011), he also promoted family-dominated, local government in which corruption continued to thrive (Myers, 2013) and insisted on his own family's participation in most construction projects.

Just as Qadhafi undercut governmental and tribal institutions by insisting on personal control and promoting family-based local systems, he also undercut his official opposition to corruption by expecting shares for his family and making it possible for local families to demand a portion as well. Practically, for MNEs with close ties to the Qadhafis, the arrangements and costs were relatively predictable and manageable: "... the people we work with, our employees and the local people where our operations were all knew what one 'had to do' in order to get those kinds of projects." (YAS, 2012).

Turkish Construction MNEs in Libya

The first Turkish MNEs entered Libya in the 1970s, and the volume of construction contracts increased dramatically in 2006 when Turkey and Libya signed a bilateral development agreement in which the Qadhafi regime granted nearly all new construction projects to Turkish MNEs (hurriyet.com.tr, 2008). By January 2011, Turkey was the second largest supplier of construction goods and services to Libya (after China), with 220 firms, US\$20 billion of ongoing projects and 124 recently approved projects worth US\$7.6 billion (www.enr.com, 2011; Turkish Contractors Association Report, 2011).

Doing business in Libya during the Qadhafi period was attractive because the projects were large, interim payments generous and accounts receivable relatively secure (Turkish Ministry of Economy, 2011). At the same time, working in the construction industry meant working closely with the Qadhafi regime, since Qadhafi and his family controlled nearly every contract, whether directly or indirectly. “If you want to do construction business in Libya, you had to engage in some relationship with the Qadhafi government, [although] the companies had the freedom to decide how intense that relationship would be” (Specialist, Turkish Contractors Association, 2011).

While it was sometimes difficult to maintain good standing with the Qadhafi family, many Turkish construction MNEs had built a record of success in Libya. As an owner of one of the smaller MNEs commented, “No matter what the costs, there are always profits in Libya” (DEY, 2011).

Initial State: Political Behavior and Strategies before the Transition

Although all eight of the firms studied were successful MNEs operating in the same sector, each firm made different choices about how to interact with the Qadhafis and with lower-level government officials, about the projects on which to bid, and about how much to invest in developing ties to local non-state actors. Table 1.2 summarizes their choices.

TABLE 1.2 Initial State – Activity in Libya as of January 2011

Firm	Posture towards Qadhafis	Invest in Ties with Bureaucrats	Invest in Ties with Families	Project Structure	Project Types	Project Locations	Projects Pending USD millions
DEY	Relational	No	No	JV Qadhafis	Private (Villas)	Benghazi	100
GUR	Middle Way	Yes	Yes	Special Authority	Public (Hospital, RR, University)	Tripoli	670
REL	Relational	Yes	Yes	JV Qadhafis	Private (Mall)	Tripoli	440
REN	Relational / Middle Way	Yes	Yes	Special Authority	Public (University, Airport)	Tripoli, Benghazi	850
SEM	Relational	Yes	No	JV Qadhafis	Mixed (Hotel, University)	Tripoli, Sirte	1300
TEK	Transactional	No	No	Global Consort.	Public (Water pipeline)	Tazerbo	490
YAS	Relational / Middle Way	No	No	Special Authority	Mixed (Palace, University)	Mitiga, Tripoli	115
YUK	Middle Way	Yes	Yes	Special Authority	Public (University, Roads)	Tripoli, Ajdabiyah	930

Posture towards Qadhafis. Relational, Middle Way or Transactional. All MNEs had to work with the Qadhafis to do business in Libya, but MNEs exhibited a preference for deep engagement with the Qadhafis (relational), a more arms-length approach (transactional) or a middle way that sought some kind of counterbalance to close ties with the Qadhafis.

Invest in Relationship with Bureaucrats. Yes or No. Some MNEs actively curried favor with mid-level bureaucrats, often through various forms of payments and gifts.

Invest in Relationship with Families. Yes or No. Some MNEs actively built relationships with locally prominent families through social functions (weddings, funerals).

Project Structure. *JV Qadhafis, JV Local Firm, Special Authority,*

Global Consortium. The choice of project structure reflected both risk/reward calculations and a firm's negotiating strength. ***Joint Venture:*** Structuring the project as a joint venture with a Libyan firm offered the potential for the highest return but at the high risk of default if either the Libyan or Turkish partner fell from favor with the government. Some MNEs chose to enter into a JV with the Qadhafis, the highest risk/return proposition. ***Special Authority:*** Entering into a contract with a specially formed government authority such as ODAC provided for direct payments (rather than through a JV partner), contractual assurances and more due process than usual. Not all MNEs qualified to work with a special authority, but those with good connections or a certain prominence qualified. ***Global Consortium:*** Occasionally, for the largest and highest profile projects, the government would contract with global consortia protected by contracts secured by global bodies. This option was open to only the largest and most global firms.

Project Types. *Private. Public. Mixed.* We designated projects associated with the Qadhafis – both as a power structure and a set of cronies – as private-benefits projects designed to benefit the elite. Examples include military projects, work on Qadhafi's palace, and private villas, hotels and malls. We categorized universities and infrastructure projects as public goods, perceived as benefitting the citizenry. Of course, some firms worked on both – and were designated as Mixed.

Project Locations. Tripoli, including the suburbs of Mitiga and Sirte were associated with Qadhafi government influence. Benghazi was, of course, a center of resistance. Away from Tripoli, local families had more influence than in Tripoli.

Interaction with Qadhafis

In line with previous studies of firm behavior in corrupt but stable contexts (Doh et al, 2003; Frederickson & Svensson, 2003; Rodriguez et al 2005), to be successful in construction in Qadhafi Libya, every firm had to cultivate close enough ties with the regime to obtain the necessary permits and permissions and to be reasonably certain of receiving payment (Specialist at Turkish Contractors Agency, 2011, Turkish Ministry of Economy Country Expert, 2012). Indeed, during the Qadhafi regime, Libyan law specifically required foreign construction companies to establish a joint venture with a Libyan partner that owned at least a 35% of the venture; these partners were invariably connected to the Qadhafi circle of influence (Turkish Ministry of Economy, 2011). To receive the most lucrative deals, MNEs typically had to form even closer relationships with the Qadhafi inner circle. One avenue was participation in family-controlled government agencies such as ODAC or LIDCO; one of the attractions of such deals was permission to side-step the joint venture requirement. Another possibility was to form a JV directly with a member of the Qadhafi family (GUR, 2011).

The eight MNEs made different choices and trade-offs about how closely to work with the Qadhafi circle in their attempts to win contracts in Libya. In keeping with previous literature (Hillman & Hitt, 1999), some chose a relational posture and invested in long-term, close ties with the Qadhafi family, while some, perhaps influenced by Qadhafi's record of changing the rules, chose a more transactional posture that emphasized short-term contracts and arms-length interactions. Departing from the purity of theory, several MNEs strove for a middle way that combined some of the closeness and commitment of the relational approach with some of the professionalism and distance of the transactional

approach; this middle way was most often accomplished by interacting with a special purpose agency such as ODAC.

On the relational end of the continuum, both REL and SEM were deeply connected with the Qadhafis and formed JVs with family members. DEY also took this path, but found a partner that was less central in the Qadhafi circle.

GUR and YUK chose the middle way and bid for projects run by ODAC. While controlled by the Qadhafis, such special authorities were staffed by bureaucrats from influential families. These civil servants established and administered fairly clear bidding and contract rules (Turkish Ministry of Economy, 2011). Hence, working with the special purpose government bodies served as a partial hedge against the risks of working with the Qadhafis directly, but still allowed fairly direct connections to the Qadhafi family. REN and YAS also followed this middle way, despite their well-known relational ties to the Qadhafis (especially to Seyf-ul Qadhafi; see the WikiLeaks documents as reported in *milliyet.com*, 2011).

Finally, although several firms spoke about keeping a distance from the Qadhafis, TEK made the biggest commitment to a transactional posture. TEK tried to maintain distance from the Qadhafi regime by joining a consortium of global MNEs and relying on contracts sanctioned by international bodies: “An important thing for us was to be as distant as possible from the Qadhafi regime. The [--] project was protected by international laws and managed by an international consortium...” (TEK, 2011). This approach provided TEK some assurances and distance, although it may have reduced somewhat their return on investment (Specialist, Turkish Contractor Association, 2012). Still, even TEK’s

determinedly arms-length approach included a relational component: The consortium included another Turkish firm with strong ties to the Qadhafis.

Libya has always been a risky context for us... [W]e needed a partner to teach us about doing business there. When we saw the opportunity of doing the [--] project, we decided to enter to Libya with through a JV with [PARTNER]. Our partner provided us the local knowledge necessary – like where to find workers, how to take care of the situation if one of our engineers faces a problem etc. (TEK, 2011)

Political and social ties to bureaucrats

The MNEs also made different choices about how much effort to invest in relationships with bureaucrats. Although Qadhafi often replaced and transferred civil servants, a more or less stable group of bureaucrats emerged over the decades: “There is lack of qualified professionals in Libya, so companies interacted with similar people during and after the Qadhafi regime.” (Specialist, Turkish Contractor Association, 2012). In addition to their ties to the Qadhafis, GUR, REL, REN, SEM and YUK all reported that they were actively engaged with bureaucrats. While many of the conversations were veiled, our interviewees suggested that the relationship building with bureaucrats followed a well-worn path of friendship, information exchange, personal gifts and deal making. Also, although all of the company executives stressed the professionalism of their relationships with bureaucrats, the Ministry and Contractors Association specialists mentioned several times the “special considerations” required to do business in Libya.

Social ties with local families

The MNEs also made varying choices about how much effort to invest in social ties with local families and so, indirectly, with various tribes. Although the Qadhafi circle controlled the flow of projects and monies, and although Qadhafi strove to reduce the power of the tribes, Libya’s tribes and families remained an important, if unofficial,

presence throughout his regime (Anderson, 1990, Myers, 2013). Further, while many bureaucrats come from local families, the firms worked with families and bureaucrats in different ways and to different ends:

Knowing families helped us to bid for projects; knowing bureaucrats and bureaucrats knowing us helped us do our job in a timely way; and being known for high quality helped us to win the bids. (REN, 2014)

The relationships with family members were built on a social foundation. For example, in addition to building close ties with the Qadhafis, YUK invested in social ties to locally prominent families in each of the geographies in which they worked:

Relationships are everything in Libya. You have to show up at your workers' and local people's weddings and funerals. You have to show them you are with them although they are not the ones who are paying you. I think ... we succeeded in building trust-based relationships with the right people in our locations. (YUK, 2012)

Finally, not all of the MNEs chose to build social ties with local families. Neither DEY nor SEM invested in ties to local families, and TEK kept its distance from both the Qadhafi family and local families, preferring to let their local partner do the relationship building.

Project type

The eight MNEs engaged in a wide array of projects including villas and shopping malls intended for the government-related elite; hotels designated for tourism and business use; infrastructure such as road and water systems; and development-oriented projects such as universities and hospitals. DEY and REL focused on private-benefit projects, with REL building malls and DEY building private villas. The others worked on public-benefit projects such as universities and infrastructure, with some, like YAS and SEM working on a mixture of public- and private-benefit projects (Specialist #1, Turkish Contractors Association, 2011; Turkish Ministry of the Economy Figures, 2013).

Having made the choices summarized in Table 1.2, the eight MNEs soon found themselves trying to cope with rebellion, military strikes and ultimately the overthrow of Qadhafi after more than 40 years of unbroken rule. No firm escaped the shock.

1.4.2 Treatment: The Arab Spring comes to Libya

In Libya, the Arab Spring arrived on 16 February 2011 in Benghazi and quickly spread to the rest of the country. Initially, both the Turkish government officials and the Turkish MNEs assumed that the Qadhafi regime would soon regain control of the country: “We were thinking that everything would return to normal in one week and we would continue our operations. We had nothing to do but wait...” (GUR, 2011). However, when the UN Security Council decided on 26 February 2011 to impose sanctions on Qadhafi and his family, some MNEs became worried. By 17 March 2011, when the UN Security Council authorized a no-fly zone over Libya, the consensus was that there was no going back. Although it took nearly eight months, Qadhafi’s reign ended on 20 October 2011. A coalition of opposition leaders, the National Transitional Council (NTC), took control of the country.

During the treatment period, Libya devolved into full-scale conflict and nearly all economic activity – and certainly all new construction – ground to a halt. Worse, many sites were destroyed by fighting; machinery was blown up or repurposed; and personnel faced a severe lack of security (Specialist #2 at Turkish Contractors Association, 2011). In short, the initial state of relationships, projects, contracts and resources was rapidly and dramatically altered, leaving the eight Turkish construction MNEs to exit or rebuild along with the rest of the country.

1.4.3 Outcomes: The Fate of the Eight Turkish Multinational Construction Firms

Table 1.3 summarizes the impact of the Arab Spring on each of the MNEs, both during and immediately after the treatment period. We report on whether MNEs received protection from local families, whether the impact on cash flows was limited or severe, whether the firms escaped proscription, whether they were able to collect their accounts receivable from the government, and whether they were invited to bid for new contracts. For comparison purposes, we provide a simple count of positive outcomes.

Outcomes during the revolution

During the revolution, the primary concern for many Turkish construction MNEs was the safety of their workers (Specialist #2, Turkish Contractor Association, 2011). While many MNEs had difficulties arranging evacuation, some were helped by local families:

The airports were closed, the roads weren't safe, but we had to evacuate our workers... Then, the most unexpected thing happened. We had built a hotel in 2009... in the far east of Libya. The owners of that hotel drove 300 km to escort us to the Egyptian Border. (REN, 2012)

Local people had trust in us. That is why they let us use the airport to evacuate our workers; many Europeans disguised themselves as working for us to be let into the airport that was controlled by the anti-Qadhafi forces. (GUR, 2012)

Looting was another big concern. While there is an element of randomness to looting (MacGinty, 2004), and many of the MNEs' sites were looted, certain sites were protected by local, non-Qadhafi forces. "Our premises were not damaged at all.... [M]en from local families came and protected our construction sites... (YUK, 2011)"

And,

In times of looting; your actions are also important. That is why we did not want to create the impression that we were escaping, while most foreign MNEs were. We

tried to stay longer. We paid our wages and debts. We even kept 20 Turkish and 42 Libyan personnel on sites, and they worked without any money. These [actions] improved our credibility in the region...That is why our university site was not looted at all. There was a colonel who was responsible from that region; he ensured the security of our construction site. There was private security at the doors. (GUR, 2012)

It is interesting that while hotels, malls and villas were looted, universities and the like were protected by local students (Turkish Ministry of Economy Expert, 2011). For example, REL's mall construction site was damaged but REN's hospital project was not (REN, 2011).

Finally, during the upheaval, normal economic activity stopped, causing disturbances in the MNEs' expected cash flows. We calculated disturbance in cash flow, adjusted for the size of the projects outstanding, to produce a very rough estimate of the economic impact of the overthrow on each firm. Thus, SEM and YAS enjoyed little impact – on the order of 1% of the financial value of the projects under contract; GUR, REN and REL lost on the order of 5%; and DEY, TEK and YUK suffered significant cash losses of 10% to 17%.

Outcomes during the immediate aftermath

After Qadhafi was overthrown and the National Transitional Council consolidated its control, the Turkish MNEs faced the risk of expropriation, the challenges of collecting the US\$5 billion owed by the Qadhafi government, and uncertainty about whether they would be invited back to finish existing projects or bid on new ones (Turkish Ministry of Economy, 2012; Specialist #1 at Turkish Contractors Association, 2012). One of the first actions of the National Transitional Council was the passage of Law 36 which froze the assets of more than 200 individuals and 78 companies associated with the Qadhafi family

(www.hurriyet.com, 2012; Turkish Ministry of Economy Expert, 2011). Companies on the list were proscribed from further work or payment. Of the companies studied, REN, REL and SEM were named directly, meaning that they faced the prospect of no payment and no future work. GUR, YAS and YUK were affected indirectly because ODAC was named. This meant that they could expect no payment but might be eligible to work in Libya in the future. For their part, DEY and TEK were not named, but DEY still faced bleak prospects because its JV partner had disappeared during the war (Specialist, Turkish Contractors Association, 2012). Only TEK was confident of payment due to the international guarantees on its contracts, although it had decided to forgo future work in Libya (TEK, 2012).

While the prospects were poor for most of the MNEs, the situation on the ground was both more complex and less grim than it appeared. For example, despite being placed on the proscribed list, REN managed to collect partial payment for its projects and received permission to continue to work on an airfield, even as two Chinese competitors were barred from airport work. REN attributed these outcomes to their political ties to mid-level civil servants who continued to serve throughout the transition.

Our airport project started again... REN was one of the few companies among both Turkish and foreign ones who started working again.... The officials are the same; they know REN. The only reason the construction started again is this authority's individual effort. The authority lobbied on the behalf of REN and was able to persuade the council to let REN continue its operations. (REN, 2012)

For their part, GUR and YUK were promised future work and allowed to collect the monies due to them from the government. The Libyan presence of DEY, SEM and REL was essentially destroyed (Specialist -1, Turkish Contractor Association, 2012), and YAS reported both serious challenges and a determination to remain (YAS, 2012).

TABLE 1.3 The Fate of the Eight – as of June 2012

Firm	Protection Provided	Limited Impact on Cash	Safe from Law 36	Project Fees Collected	Future Work Promised	Outcome Count
DEY	N	N	Y	N	N	1.0
GUR	Y	Partial	Partial	Y	Y	4.0
REL	N	Partial	N	N	N	0.5
REN	Y	Partial	Partial	Y	Y	4.0
SEM	N	Y	N	Y	N	2.0
TEK	N	N	Y	Y	N	2.0
YAS	N	Y	Partial	N	N	1.5
YUK	Y	N	Partial	Y	Y	3.5

Protection Provided. During the worst chaos, some MNEs enjoyed active protection by local families (Y).

Limited Impact on Cash. Thanks to data provided by the Turkish Ministry of Economy, we were able to estimate economic impact by calculating the disturbance of cash flow as a percentage of the value of outstanding contracts. The percentages ranged from 0% of the outstanding project amount for SEM to more than 17% for DEY. There were three clusters: Those with under 2% impact, coded as Y; those with approximately 4-5% disturbance, coded as Partial; and those with 10% or more disturbance, coded as N.

Safe from law 36. On May 20, 2012, the National Transition Council passed Law 36 which froze the assets of and proscribed certain MNEs from further work or payment. Those perceived as closest to the Gaddafi regime were placed on the list (N); others found their partners such as ODAC on the list, and were thus indirectly affected but not proscribed (Partial), and some were free of taint (Y).

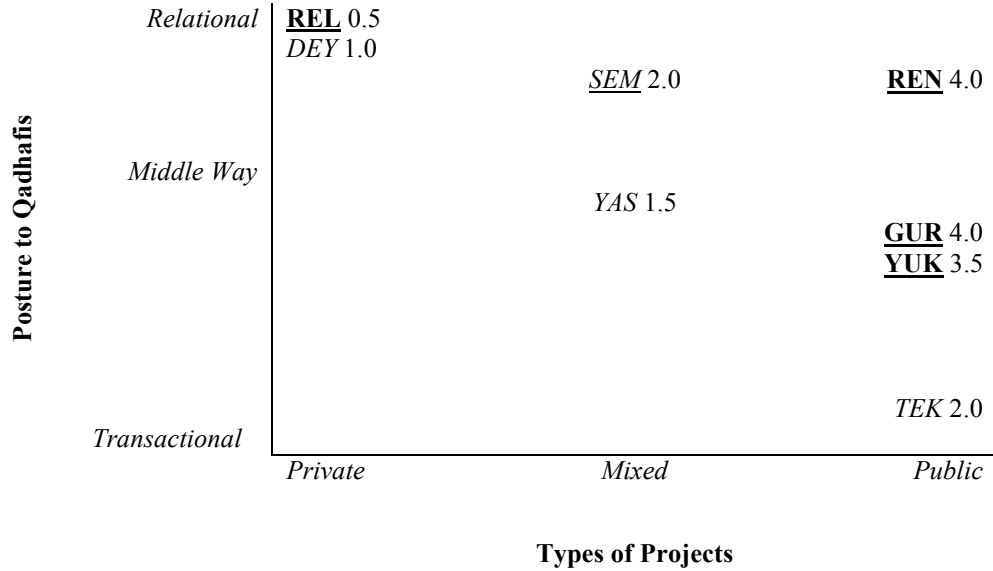
Project Fees Collected. Whether past-due accounts were collected more than 80%, was self-reported.

Future Work Promised. The firms coded Y reported credible signals that they could expect future work from their contacts in Libya; we cross-checked the firms' impressions with the opinion of a representative of the Contractors Organization.

Outcome Count: This is a simple count that suggests relative outcomes. 1 point for each Y; 0.5 for Partial; 0 for N; maximum 5.

The Relationship between Pre-treatment Choices and Outcomes

To attempt to visualize possible relationships between initial conditions and outcomes after the treatment period, we experimented with several figures until we settled on the matrix depicted in Figure 1.1. This matrix arrays the companies along an X axis from private-benefit to public-benefit projects and along a Y axis from a transactional to a relational posture to the Qadhafis. The company name is underlined if the MNE invested in (often corrupt) ties to bureaucrats. The name appears in **bold** if the MNE built social ties with local families. Finally, for comparison purposes only, we report a simple count of the positive effects during or immediately after the transition. The positive effects were Protection during Looting, Limited Impact on Cash, Safe from Law 36, Project Fees Collected, and Future Work Promised – for maximum possible count of five. Although only an approximation of impact, this count provides a relative sense of which MNEs coped better, or at least suffered less (higher numbers), versus those that suffered more (lower numbers).



Bureaucrat Ties: Underlined MNEs invested in ties with bureaucrats; those without did not.

Family Ties: MNEs listed in **bold type** invested in ties with families; those in *italic type* did not.

Outcomes: The numbers reflect simple counts of positive outcomes and are useful only for comparisons – that is, those with 3s suffered less than those with 0s or 1s.

Figure 1.1 Critical Determinants of Outcomes, June 2012

Within the context of this natural experiment, the pattern of results summarized in Figure 1.1 highlights several relationships between factors. Although the close association with the Qadhafis proved as disastrous as might be expected for DEY, REL and to some extent SEM, other factors trumped close association with the Qadhafis. Thus, GUR, REN, YAS, SEM and YUK all cultivated close ties with the Qadhafis (though YAS sought to obscure their ties), and all but YAS and SEM were top performers.

The pattern of findings suggests that one important factor was the type of project: MNEs associated with public-benefit projects (GUR, REN, TEK, YUK) all performed better than those associated with private-benefit projects (DEY, REL). TEK's indifferent result might seem to throw doubt on the positive impact of public-benefit projects, but its decision not to pursue further projects was voluntary; had it chosen to apply, the outcome count would have been a more respectable 3.0. Further, although arms-length dealings did not guarantee good results, the combination of a transactional approach with a commitment to public-service projects proved relatively effective, at least for TEK as compared to YAS.

The pattern of findings also suggests that investing in ties with families and bureaucrats was useful, in as much as the top three performers – GUR, REN and YUK – all made such investments. For example, even though REN was so closely associated with the Qadhafis that it was placed proscribed list, REN was able to escape both looting and the full force of Law 36 by pursuing a complex path in which they built strong ties to both the Qadhafis and with bureaucrats from influential local families. This proved beneficial because local families maintained positions of influence within these agencies, and neither the Qadhafi

regime nor the National Transitional Council ever exercised complete control over the bureaucrats and their social, kin and loyalty ties. Instead, there was scope for independent action – including the bureaucrats’ decision to pay REN and let it continue its work on the airport, despite its being on the proscribed list (REN, 2011). Similarly, SEM’s ties to bureaucrats helped to limit its losses and collect project fees, even though it was on the proscribed list with no prospect of future work.

It is notable that, excluding SEM, all firms that invested in ties to bureaucrats also invested in social ties with families. While some of the interviews differentiated between the effects of social ties to families and political ties to bureaucrats (REN, 2014), the reality that all bureaucrats were from locally prominent families and limitations in our data does not allow us to tease out whether social ties to families had an effect independent of political ties to bureaucrats.

On the other hand, it is clear that ties to families and bureaucrats were not enough to overcome the impact of REL’s relationship to the Qadhafis and its work on private-benefit projects. That GUR, YUK and especially REN has similarly strong ties to the Qadhafis, families and bureaucrats but did much better than REL suggests that the critical variable is project type. Still, if project type were entirely dominant, then TEK should have scored the same as GUR and YUK. In short, while project type seems to be the more powerful factor, ties to families and bureaucrats seemed to have an incremental effect on a firm’s ability to survive political upheaval.

Summarizing these observations, the relative success of GUR, REN and YUK suggests that most effective protection from political turmoil was a concrete and visible

demonstration of commitment to the society at large through project type *plus* the investment in ties to local families and bureaucrats.

1.4.4 Boolean Exploration of Alternative Explanations

We used Boolean Truth Tables to expand our four factors to include the potential influence of five additional factors – international experience, firm size, the existence of international guarantees, location of operations, and investment in post-transition CSR activities – and then to look for patterns of logically possible causality that we might have missed in our previous analysis.

We included details of geography and proximity because they have been shown to have an impact on how well MNEs fare during violent disruptions (Dai, Eden, & Beamish, 2013). For example, it is at least conceivable that by working on a private-benefit project in Benghazi, the heart of resistance to Qadhafi, caused DEY to suffer all the more for being associated with the Qadhafis.

Other research suggests that firms from emerging economies with experience coping with challenging institutional settings (Cuervo-Cazurra & Genc, 2008), rapidly shifting political winds (Farashahi & Hafsi, 2009), turbulent markets (Yaprak & Karademir, 2011) and/or sudden shocks such as terrorist attacks or natural disasters (Oetzel & Oh, 2014) develop special capabilities for thriving in uncertain political and institutional waters (Cuervo-Cazurra, 2011). In addition, firm-specific factors such as size might interact with political behavior choices to effect outcomes (Hillman & Hitt, 2005). Similarly, there is some sentiment that international guarantees might have helped firms limit cash losses and collect project fees (Specialist, Turkish Contractors Association, 2012, Expert, Turkish

Ministry of Economy, 2012). Therefore, we added MNE international experience, firm size and international guarantees to the set of possible factors.

Finally, it is possible that investment in post-transition corporate social responsibility type projects could have counteracted the reputational effects of association with the Qadhafis (Doh & Ramamurti, 2003, Gifford & Kestler, 2008, Gifford, Kestler, & Anand, 2010, Zhao, 2012). In fact, shortly after Qadhafi fell, the National Transition Council requested that several of the MNEs studied (GUR, REN, SEM, YUK) invest in 22 different CSR activities, such as the construction of an elementary school in Tobruk and the renovation of a mosque in Tripoli (Expert, Turkish Ministry of Foreign Affairs, 2014).

TABLE 1.4 Boolean Analysis of Alternative Explanations

Inputs					Extensive Int'l Expertise	Large Size	Int'l Contract	Close to Tripoli?	CSR Project?
	Rel. w/ Qadhafis	Ties to Bureaucrats	Ties to Families	Social Project?	E	F	G	H	I
	A	B	C	D					
DEY	1	0	0	0	0	0	0	0	0
GUR	0	1	1	1	1	1	0	1	1
REL	1	1	1	0	0	0	0	1	0
REN	1	1	1	1	1	1	0	1	1
SEM	1	1	0	0	0	1	0	1	1
TEK	0	0	0	1	1	1	1	0	0
YAS	1	0	0	0	0	0	0	1	0
YUK	0	1	1	1	1	1	0	1	1

Outcomes	Protection Provided	Limited Impact on Cash	Partially Safe from Law?	Project Fees Collected	Future Work Promised
DEY	0	0	1	0	0
GUR	1	1	1	1	1
REL	0	1	0	0	0
REN	1	1	1	1	1
SEM	0	1	0	1	0
TEK	0	0	1	1	0
YAS	0	1	1	0	0
YUK	1	0	1	1	1

Simplified Boolean Combinations*	BCDEFgH	BCDEFgH+ABCdefgH+AbCdeFgH+AbcdefgH	BCDEFgH+Abcdefg+abcDEF Gh	BCDEFg HI+abcD EFGhi+A BcdeFgHI	BCDEFgHI
Factored Boolean Expression	EFgH BCD	gH FE(BCD+ABcd) fe(Abcd)	g FEH(BCD) fe(Abcd) GEFh abcD	FgHI BCDE+A Bcde FGhi abcDE	EFgH BCDI

**(Upper case = presence; lower case = absence; bold to aid interpretation)*

Survival Table

Variable	A	B	C	D	E	F	G	H	I	BD	BCD
Survival	2	7	6	8	6	6	3	5	2	6	5
Total # of Equations	11	11	11	11	11	11	11	11	4	11	11

Table 1.4 summarizes the factors considered and shows the result of Boolean addition and logical minimization. Following Ragin (1994, 2008, 1987), possible explanatory factors and observed outcomes are coded as 0 for “non-occurrence” or 1 for “occurrence,” respectively. Each configuration of 0s and 1s (here denoted as lower and upper case letters, respectively) indicates interactions that led to an outcome. Once these configurations were organized into a Truth Table, Boolean addition and multiplication were employed to collect configurations of factors associated with specific outcomes.

In the results reported in the last two rows of Table 1.4, the upper case letters indicate the factors the *presence* of which influenced the result, while lower case letters indicate the factors the *absence* of which influenced the result. The bold type and factored versions of the results serve only to aid interpretation of complex expressions (Ragin, 2008).

For example, GUR, REN and YUK were promised future work. The raw Boolean expressions associated with this outcome were aBCDEFgH (for GUR), ABCDEFgH (for REN) and aBCDEFgHI (for YUK). These expressions were then combined with the raw expressions that did *not* lead to “future work promised” to identify which factors were sufficient, necessary, necessary but not sufficient, or necessary and sufficient. The result of these steps indicate that the simplest combination of factors always associated with “future work promised” was BCDEFgHI: To obtain the promise for future work, a firm had to build relationships with bureaucrats (B) and families (C), invest in social benefit projects (D), bring international experience (E), be of large size (F), *not* rely on international guarantees (g), locate close to Tripoli (H) and engage in post-entry CSR activities (I).

The factored results provide additional insight when interpreting the results. Thus, the “protection provided” result was associated with the same BCDEFgHI pattern as was the “future work promised” result. When factored, the first line of the factored form indicates that protection was provided to the large (F), experienced (E) firms located near Tripoli (H) but operating without international guarantees (g) if they also (second line) invested in public-benefit projects (D) and in ties to bureaucrats (B) and families (C). The trio of investments in public-benefit projects, ties to bureaucrats and ties to families also protected large firms from cash flow problems and from Law 36. When with CSR investment (I) was added, the new four-factor combination was linked to project fee collection and the promise of future work.

Taken together, the results of the Boolean analysis confirm that the combination of public-benefit projects and ties to non-Qadhafi bureaucrats and families was critical to firm survival after the overthrow of the regime with which they had been closely associated. Other factors – such as being a large international firm with an arms-length relationship to Qadhafi or investing in post-transition CSR public-good projects – also proved important, but perhaps less so. And finally, as expected, close association with the Qadhafis without any mitigating factors proved disastrous.

1.5 Theory Building: Hedging Political Risk by Building a Social Sector Path to

Firm Legitimacy

The experience of the eight Turkish multinational-construction MNEs during a period of abrupt regime change in Libya reinforces the intuition that association with an overthrown government is detrimental to firm health while also showing that the successful firms were

those that hedged their bets by building social ties to seemingly peripheral actors *and* by investing in projects that were seen to benefit society rather than cronies of the regime. Our findings suggest a social path to legitimacy – and so the continued license to operate – that can buffer MNEs operating in uncertain and volatile contexts from significant political risk, including the existential threat of abrupt regime change.

Public-Benefit Products or Services Enhance Firm Resilience

Perhaps the most striking aspect of our findings is the consistent and strongly positive impact of project type on survival. Work on public-benefit projects conferred protection, improved business outcomes and the promise of future work; work on private-benefit projects provided none of these benefits during or after the transition. In fact, projects that benefitted society rather than cronies of the regime led to positive action by social actors to protect the firm's projects – both during and after the transition. Further, in three of four cases, investment in public-benefit CSR projects such as mosques and schools after Qadhafi's ouster was associated with positive longer-term outcomes such as the promise of new work and the license to stay. That is, the association with public-benefit projects seems to confer both pragmatic legitimacy and moral legitimacy in the eyes of social sector evaluators (Bitektine, 2011, Hadjikhani, Lee, & Ghauri, 2008). Thus,

Proposition 1a: Involvement in public-benefit products or services *before* a political transition will enhance an MNE's resilience in the event of abrupt political change.

Proposition 1b: Involvement in public-benefit products or services *after* a political transition will moderate the backlash against MNEs in the event of abrupt political change.

Further, because involvement in CSR activities after the transition seemed to have less impact than involvement in public-benefit projects *before* the transition, we would speculate the prior involvement public-benefit products or services will prove more effective than involvement after the fact.

Social Ties Enhance Firm Resilience

In countries with legitimate governments and reasonably well functioning institutional and social structures, firms complement their legitimacy-enhancing political behavior with multilateral political behavior directed towards to non-state actors with some sort of power base amongst the citizenry. By engaging with advocacy groups, consumers, labor, nonprofits and the media, MNEs enhance their legitimacy in the eyes of such non-governmental entities (Dacin, Oliver, & Roy, 2007); develop alternative conduits of information (Doh & Guay, 2006, Doh & Teegen, 2002, Teegen, Doh, & Vachani, 2004); and influence government through the mobilization of non-governmental actors (Hadjikhani & Ghauri, 2001). More specifically, by building social ties to citizen-based, non-state centers of power, MNEs enhance both their influence (Dieleman & Sachs, 2008, Frynas, Mellahi, & Pigman, 2006) and their moral legitimacy (Bitektine, 2011, Claasen & Roloff, 2012). Such activity becomes more challenging in countries such as Libya in which non-state actors such as NGOs or think-tanks have been systematically dismantled (Kinsman, 2011), but our findings show that there remain more decentralized and unofficial loci of local power, such as the families in Libya, to which firms might turn. Our data make it difficult to distinguish whether social ties to families helped the Turkish MNEs pragmatically – for example by providing connections to individuals who became part of

the new power structure – or more indirectly by enhancing the firm’s moral legitimacy in the eyes of influential families. Either way,

Proposition 2: Building social ties to local social sector actors, such as families and tribes, *before* a political transition will enhance an MNE’s resilience in the event of abrupt political change.

Further, because bureaucrats tend to remain influential even when their political masters change (General Secretary-Turkish Contractors Agency, 2013; Tsai, 2011), ties to bureaucrats can pay off even when the sponsoring government collapses. In our findings, the positive effect of ties to bureaucrats are closely associated with short-term transactions, specifically the securing of cash flow and collecting of project fees. Thus,

Proposition 3: Building social ties to bureaucrats *before* a political transition will enhance an MNE’s ability to continue to complete transactions with the government even in the event of abrupt political change.

As influential as are either project type or social ties, the results of the Boolean analysis suggest that the combination is especially potent.

Proposition 4: The combination of involvement in public-benefit products or services with the building of social ties to bureaucrats or social sector actors *before* a political transition will enhance an MNE’s resilience in the event of abrupt political change more than will either tactic alone.

Finally, the relative weight of our results suggest that although both project type and social ties are important, public actions are likely to speak louder than private words, such that involvement in public-benefit products or services may well have more impact on MNE

resilience in the event of abrupt political change than will building social ties to bureaucrats or social sector actors.

The Social Sector Path to Legitimacy as a Hedge to Political Risk

Experiments allow generalization to theory, and our findings support the notion that the attaining and retaining legitimacy in the eyes of a broad swath of society may well be critical to the success of MNEs in *any* politically uncertain context. When faced with institutional and political uncertainty, including but not limited to the possibility of abrupt regime change, the search for legitimacy seems to require attention to the perceptions of those who are governed as well as attention to the perceptions of the government (Cassinelli, 1959). The working assumption in much of the literature on political risk and corporate political behavior has been that the government is a credible counter-party and that working with the government confers a “seal of approval,” and thus a degree of legitimacy, to the MNE (e.g., Boddewyn & Brewer, 1994: 135). But as we have seen, when citizens’ support for government is uncertain, the seal of approval can easily become a mark of shame that threatens the MNE’s license to operate in a country, because “the domestic perception of legitimacy of the MNCs’ operations is tied to the domestic perception of the legitimacy of the institutional framework under [which] the foreign firm is operating” (Bucheli & Kim, 2012: 848). That is, the legitimacy of the government and associated institutions in the eyes of the governed is critical to considerations of political risk (Jost & Major, 2001, Tost, 2011). For governments and institutions to be perceived as legitimate by citizens, they must be perceived as exerting power with some measure of fairness and impartiality for all, not for merely for the benefit of a few (Berger, Ridgeway,

Fisek, & Norman, 1998, Berger, Zelditch, Anderson, & Cohen, 1972). Thus, a government's legitimacy depends on the consent of the governed (Gilley, 2006), and MNEs would do well to court the support of the society at large.

The experience of the Turkish MNEs in Libya shows that firm legitimacy need not be lost even when support for a government collapses. Although Qadhafi's loss of legitimacy in the eyes of the citizenry called into question the taken-for-granted cognitive legitimacy of all MNEs associated with the Qadhafi family, the MNEs with the a combination of public-benefit projects and ties to families in the social sector were able to claim enough pragmatic and moral legitimacy in the eyes of families and other stakeholders that the firms survived with their license to operate more or less intact. Just as the collapse of the regime threw the question of government legitimacy back into the social sector for the citizenry to sort out, so did the collapse of the regime throw the question of MNE legitimacy back into the social sector for an evaluation of the MNEs' pragmatic and moral legitimacy. From this experience, we suggest that precisely when political risk is high and the government-based or other officially sanctioned paths to MNE legitimacy are shaky because of a weak or unpopular government and associated institutions, the social-sector-based path to firm legitimacy and the license to operate will become all the more salient (Bucheli & Salvaj, 2013).

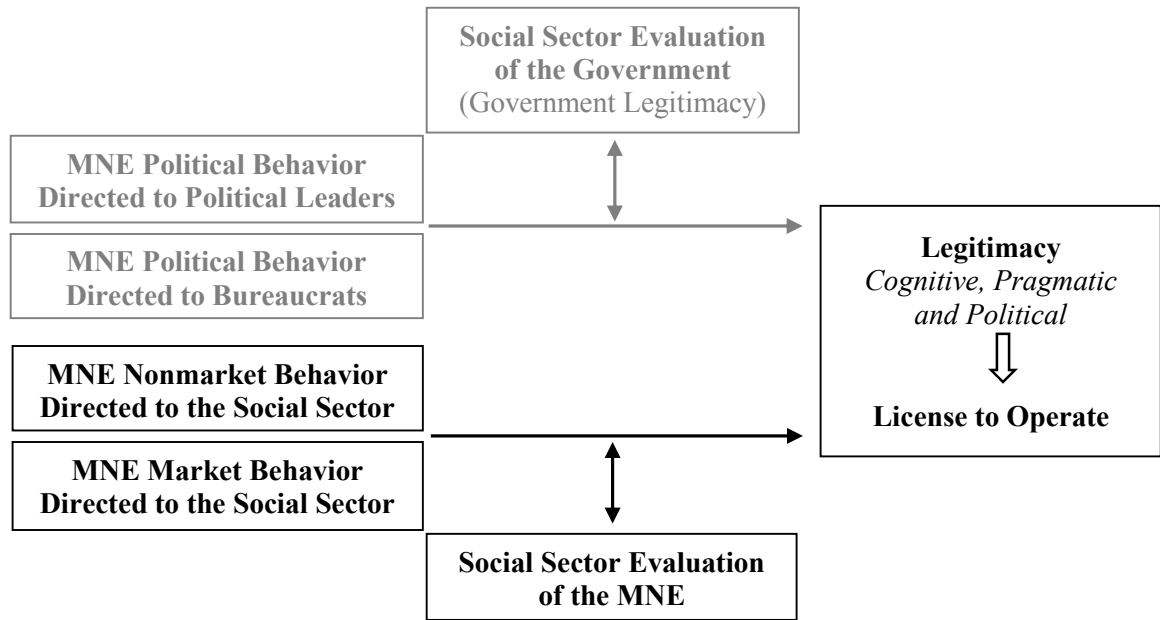


Figure 1.2. A Model of the Impact of the Social Sector on Firm Legitimacy

Figure 1.2 illustrates a two-path model of firm legitimacy, inspired by in part by Boddewyn and Brewer's model of government-based firm legitimacy (1994: 121). The gray portion of the proposed model shows the government-based path to MNE legitimacy. The firm's political behavior directed to both political leaders and bureaucrats in the government serve to enhance the firm's pragmatic legitimacy, while its association with the government over time increases its cognitive legitimacy. These effects are likely to hold so long as the government involved retains its own legitimacy in the eyes its citizenry, including various social sector entities from families to tribes, NGOs and the media.

The black portion of the proposed model shows the social-sector-based path to MNE legitimacy. The firm's market behavior (its portfolio of products and services) and nonmarket behavior (relationship building) directed to various social sector entities combine to enhance the MNE's moral and pragmatic legitimacy in the eyes of the social sector; if repeated over time, these interactions will contribute to the MNE's cognitive legitimacy and are likely to hold so long as the MNE maintains active and transparent interactions with the social sector (Claasen & Roloff, 2012, den Hond, Rehbein, de Bakker, & Kooijmans-van Lankveld, 2014).

Finally, the model shows that the social path to legitimacy complements the political path to legitimacy – and suggests that when a government's legitimacy is called into question, the social-sector-based path may well substitute for the government-based path to firm legitimacy.

Thus, and especially when faced with political and institutional uncertainty and volatility,

Proposition 5: MNEs can enhance their license to operate, and hedge against the possibility of a government losing legitimacy in the eyes of the governed, by engaging in a variety of market and nonmarket activities designed to cultivate moral and pragmatic legitimacy in the eyes of the social sector.

1.6 Discussion & Conclusion

We make use of the natural experiment occasioned by the sudden overthrow of the Qadhafi regime during the Arab Spring to explore what actions MNEs might take during stable periods to bolster broad-based legitimacy and so increase the likelihood of survival during periods of political and institutional upheaval. Building on the causal relationships suggested by the natural experiment, we propose a social sector-based path to firm legitimacy and the license to operate that complements, and when government legitimacy is questioned may replace, the more commonly understood government-based path to firm legitimacy and the license to operate.

More concretely, our results show that MNEs can overcome the deleterious effects of close association with an outgoing government by actively engaging social sector actors through both product or service choice and the cultivation of ties to actors in the social sector. By complementing political behavior aimed at influencing the government with social behaviors that cemented ties to local families, some of the MNEs that we studied secured non-governmental sources of pragmatic and moral legitimacy and so improved their resilience during a radical transition in the political context. Further, the social ties to specific families enhanced the firms' very pragmatic connections to bureaucrats who maintained relationships with the MNEs even as the government changed hands. Finally,

our results highlight the importance of market behavior (project type) in building social-sector-based legitimacy for an MNE: Focusing a firm's efforts on goods or services that benefit the society at large, rather than the ruling elite, goes a long way to establishing and maintaining pragmatic and moral legitimacy that can survive political and institutional turmoil, including regime change.

Our findings contribute to the political risk and political behavior literature the notion that the pursuit of firm legitimacy in general, and especially in the eyes of social sector actors, is an effective hedge against political risk. More generally, our findings support an elaboration of Boddewyn & Brewer's (1994) theory of the interaction between MNE political behavior and legitimacy by describing a parallel path to firm legitimacy in a host country – a path that focuses on firm legitimacy building efforts directed to the social sector. This extension draws from new institutionalism to contribute to theories of political risk and corporate political behavior the notion of a social-sector-based path to firm legitimacy and the license to operate that complements, and may at times substitute for, the government-based path to firm legitimacy (Bucheli & Kim, 2012, Bucheli & Salvaj, 2013). At the same time, the proposed model reinforces highlights for new institutionalism the role of concrete, material activities (i.e., project types) as well as symbolic activities in the shaping of legitimacy: In practice, market and nonmarket behaviors combine – and can either reinforce or contradict each other – in the earning and maintaining of social-sector-based legitimacy for firms (Hadjikhani, Lee, & Ghauri, 2008, Scherer, Palazzo, & Seidl, 2013).

For managers, the implications are, first, that attention to legitimacy building in the eyes of the social sector is likely to be a useful hedge against political uncertainty; second,

that the firm's products and services are as important in building such legitimacy as are their nonmarket behaviors; and third, that directing both market activity and nonmarket legitimacy building activity to as broad a swath of social sector actors as possible will pay off, even when the social sector is underdeveloped. Further, the pursuit of firm legitimacy in the eyes of citizens may begin to address, although not resolve, the ethical issues implicit in building political, and sometimes corrupt, ties with autocratic governments. By building social legitimacy, a firm's dependence on political and/or corrupt ties might be reduced; by emphasizing goods and services that benefit society at large, firms might begin to mitigate the harm from corruption and support of an unsavory regime; and by engaging with social sector actors, firms might contribute in a small way to the improvement of the quality and durability of economic, political and social sector institutions (Oetzel & Doh, 2009).

While useful for theory building and suggestive for managers, the natural experiment recounted here consists of a small number of cases from a single industry operating in a single context. Thus, the findings should be replicated and the theoretical ideas should be tested in both cross-sectional and longitudinal studies of MNEs operating in other industries and under other institutional configurations. Further, due to limitations of collecting data during and after a war, the measures of impact are blunt: Protection or not, proscribed or not, future work promised, and so on. All of these admit nuance and alternative interpretations. Although the combination of measures combined with the consistency of the results makes for a convincing story, future research should employ much more precise measures.

Similarly, the lack of a developed social sector structure beyond families (due to years of repression) and the limitations in our data combined to reduce visibility into the operative mechanisms. While we believe that the stories of protection of university project by students and the nonspecific impact of public-benefit projects combine to suggest that the social sector's evaluation of both moral and pragmatic legitimacy is the mechanism that animates our story, we cannot definitively separate the effects of moral versus pragmatic legitimacy or even of legitimacy formation from the more direct effects of social and political ties. For example, it could be that the positive impact of ties with families had more to do with their (more or less corrupt) ties with bureaucrats and/or the effect of having a connection within the new government than with the development of a more broad-based legitimacy. To demonstrate the connection between public-benefit projects and firm legitimacy, it would help to trace the impact of association with a public-benefit project on the opinions and perceptions of social sector entities such as advocacy groups, customers, labor, nonprofits, or media. To demonstrate the connection between social ties to families and firm legitimacy, it would be useful consider the evolution over time of individual perceptions, the pronouncements of family leaders, and the emerging network of social ties. And to test the impact of social ties, one would look for evidence of *quid pro quo* dealings.

Finally, since both MNEs and at least some non-state actors (or networks of non-state actors) span country boundaries, we would welcome an opportunity to expand this analysis from the subsidiary-host country level of analysis to a multi-level, system-wide analysis. For example, the variation among the Turkish MNEs' choices and trajectories is consistent with Kostova et al.'s (2008) suggestion that MNEs can pursue legitimacy through multiple

paths, shaped as much by each MNE's internal profile as by that of the host country. For example, in our study, TEK achieved some success before and after the transition with an arms-length strategy, while REN doubled its investment in relationships by focusing simultaneously on Qadhafi and social-sector relationships. The path chosen by each firm seems to match that firm's constraints and skill sets: TEK was a public firm committed to transparency and able to draw from extensive experience in global consortia, while REN enjoyed less scrutiny as a private firm and was able to draw on extensive experience managing successful projects in some very challenging business environments including Russia and much of Central Asia.

More broadly, the ability of MNEs to draw on experience in many institutional settings might help MNEs loosen (if not completely break) the bars of the invisible cage of legitimacy (DiMaggio & Powell, 1991) in any particular setting. This possibility fits with recent advances in new institutional theory that argue for a greater role of agency, albeit embedded, in the articulation of institutional logics (Greenwood & Suddaby, 2006, Hirsch & Lounsbury, 1997). Pragmatically, this possibility would be consistent with an activist, country-shaping role for MNEs – as illustrated by recent calls for MNEs to contribute to the building of civil society in the developing world (Lehrer & Delaunay, 2009).

In conclusion, this paper reinforces the idea that MNE success in contexts with high political risk, and possibly in all settings, requires a multilateral, integrated strategy in which MNEs combine market and nonmarket behaviors to engage both government and social sector actors, ranging from global stakeholders to mid-level bureaucrats to non-governmental centers of power. Clearly, more work is required to test these ideas in a wider variety of settings and industries, but at a minimum, our findings suggest that to maintain

legitimacy in the eyes of the people of a host country with weak institutions and high political risk, MNEs would do well to earn the support of social sector actors through a combination of market and non-market efforts. Earning such broad-based legitimacy should provide resilience in the face of political risk and uncertainty, but, we hope, will also lead to a more constructive and mutually beneficial engagement between MNEs and their stakeholders in host countries.

NOTES

¹ Although we would have preferred to secure more interviews, this proved impractical due to conditions on the ground, concerns about confidentiality, and other challenges associated with the volatility of the situation in Libya. Further, because of the dangers at the time of the interviews, we also promised our informants that we would take modest steps to disguise the names of the MNEs as well as certain details. While these concerns are less pressing today than during the data collection period, we have maintained the cloak of anonymity. In so doing, we have taken care not to distort critical relationships, relative scale, or the like.

² Appendices with quotations, coding and some initial diagrams are available from the corresponding author.

CHAPTER 2

A DYNAMIC VIEW OF POST-ENTRY CHOICES OF MNE RETAIL FIRMS: EFFECT OF EXPERIENCE AND INITIAL PERFORMANCE

ABSTRACT

Our study reviews multinational retail firms' operations after they have entered a foreign country and tracks the change in their ownership and positioning choices within that country. We investigate the internationalization histories of each retail firm by constructing a dataset that tracks the changes in ownership, format, performance outcomes and external conditions, from 1992 to 2014. We find that multinational retail firms change their market entry choices as a result of continuous and discrete types of experiences in those countries. That is, their accumulated experiences which are continuous experiences trigger change in their entry decisions at post-entry, and their initial performance, which are more discrete experiences affect this relationship. Our results indicate initial poor performance experience positively moderates increases in ownership, and negatively moderates increase in number of formats due to higher levels of accumulated experience. Lastly, we find that altering ownership and format changes at post-entry increases retail multinational's' probability of continuing their operations at host-countries.

Keywords: MNE Internationalization Process, Entry-modes, Adaptations, Knowledge Transfer, Learning

2.1 Introduction

Earning rents from firm specific knowledge often entails reusing it effectively in different settings (Teece, Pisano & Schuen, 1997). It makes economic sense for an organization to leverage superior routines by reusing them rather than recreating them *de novo* in each new setting (Nelson & Winter, 1982, Winter, 2003) as the replication of existing capabilities in new contexts is a common strategic route for organizations to stretch the “life cycle” of their existing resources and capabilities (Helfat & Peteraf, 2003). Therefore, firms increasingly transfer their existing knowledge within their boundaries to their subsidiaries located in a different context (Jensen & Szulanski, 2004, Kogut & Zander, 1993, O'Dell & Essaiades, 1998), which involves creation and operation of a large number of similar outlets that deliver a product or perform a service (Winter & Szulanski, 2001).

The success of such replication strategy depends on MNE's ability to adapt, (re)combine and (re)deploy existing knowledge and integrate it with the new knowledge generated at the subsidiaries (Ambrosini & Bowman, 2009, Eisenhardt, 2000, Ghoshal & Nohria, 1989, Gupta, 2000, Helfat & Peteraf, 2003, Winter & Szulanski, 2001, Yang, Mudambi, & Meyer, 2008). Since these forward and reverse knowledge flows are crucial for competence exploiting or creating activities (Foss & Pedersen, 2004, Jonsson & Foss, 2011), MNEs are under continuous pressure to leverage internal and external networks of knowledge (Ghoshal & Bartlett, 1990, Jensen & Szulanski, 2004, Winter, Szulanski, Ringov, & Jensen, 2012). Moreover, knowledge transfer is a sticky process (Szulanski, 1996) and expanding internationally to an economically, culturally and institutionally distant locale brings many uncertainties for MNEs (Feinberg & Gupta, 2009). Therefore, it's very

important for the MNEs to decide on the optimal level of commitments and efficient firm boundaries at the host countries by accounting for multiple distances and uncertainty involved cross-country knowledge transfer (Santos & Eisenhardt, 2005, Wolter, 2008).

Prior literature introduces market entry strategies as the first step to overcome challenges and uncertainties related with internationalization (for a review, see Caves, 2007). The literature on entry-mode investigates MNEs' different ownership choices during their entry to different countries, through which they achieve organizational control and/or flexibility to mitigate the investment risks related to the uncertainties (Brouthers, Brouthers & Werner, 1999, Zhao, Luo, & Suh, 2004). Another strand of literature suggest that MNEs are also required to align their strategies other than ownership including deciding how to offer their services at market entry (Figueira-de-Lemos et al, 2011; Benito, Petersen & Welch, 2011). These studies have looked at how MNEs strategically position their product /service offerings in new contexts which are also important for their market-entry performance. However, most of the studies typically ignore what happens after a market entry decision is made (Blomstermo et al. 2005; Brouthers & Hennart, 2007).

On the other hand, internationalization is a dynamic process where the host country environments are prone to change (Cantwell, Dunning, & Lundan, 2010, Johanson & Vahlne, 1977; Kogut & Zander, 1993, Madhok & Liu, 2006, McKelvey, 1997). Standardization and adaptation-related learning continues after MNEs enter a location (Anderson & Gatignon, 1986, Blomstermo, Sharma, & Sallis, 2006, Brouthers & Hennart, 2007, Kogut & Zander, 1993). MNEs uncertainty perceptions change as a result of their accumulated knowledge at the host-countries (Figuera-de Lemos et al, 2011). Therefore,

the initial decisions that the MNEs had made at the market entry might become sub-optimal over-time and it's important to understand how MNEs achieve fit continuously with changing conditions at the host countries. (Cantwell et al, 2009; Feinberg & Gupta, 2009; Verbeke, 2003).

In this paper, we focus on explaining the process which leads to changes in MNEs' post-entry commitments. The context of our study is multinational retail firms as this context provides us an environment in which to investigate multiple pressures of standardization and adaptation and variation in market entry choices of ownership and positioning at post-entry. The international retailing literature recognizes that internationalization is a strategic process that does not begin or end with market entry only (Palmer & Quinn, 2005; Vida & Fairhurst, 1998). For these firms, the post-entry changes occur in terms of increasing or decreasing their ownership or number of formats they offered at the host host-countries (Palmer & Quinn, 2005).

From a theoretical perspective, we investigate the effect of host-country specific learning on commitments made at the same country, rather than sequentially increasing commitments from experiences in other countries (Argyres & Mayer 2007, Ruigrok & Wagner, 2003). Our main argument is that as MNEs learn more about the host country environment, they adapt and adjust their initial positions to achieve a better fit at post-entry (Benito et al, 2009; Lewin & Volberda, 1999). We introduce two different types of learning that triggers the co-evolution of MNEs at host countries and prompts the multinational retail firms to change their initial choices: continuous and more discrete experiences. First, we argue that MNEs can change those choices as a result of experience they accumulate

over the years in the host countries to improve their fit to the host-country conditions further (Brouthers & Bamossy, 2006, Kogut, 1991, Kogut & Zander, 1993, Tallman, 2003), Second, we argue that MNEs can change them as after they observe the initial positive or poor performance outcomes related with their market-entry choices (Chung & Beamish, 2012, Chung & Beamish, 2010, Zhou, David, & Li, 2006). Then, we investigate effect of changing ownership and format choices at post-entry on multinational retail firms' survival in host countries.

We find that multinational retail firms' accumulated experience is positively related to changes in ownership and format, specifically with more levels of experience they increase their ownership and number of formats they introduce. Similarly, while the initial failure prompts them to make changes at post-entry, while not being as a statistically strong relationship as the initial failure case, the initial success is negatively related to changes in ownership and format at post-entry. Our results also suggest that initial failure positively moderates the positive effect of accumulated experience on increasing ownership and number of formats, while initial success, again being a less strong result this time, negatively moderates this relationship. Lastly, we find that MNEs that change their initial choices, controlling for other conditions, are more likely to survive and continue their operations at the host-countries.

Our inquiry is timely as many studies have been asking for studies on post-entry dynamics at the focal countries (Benito et al, 2008) and the need for research on co-evolutionary perspective of the MNEs and their entry decisions (Cantwell et al, 2009; Hennart & Slangen, 2015). Moreover, while there is an established literature on retail firms'

internationalization, research on effects of learning on retail firms' internationalization process is not much studied (Palmer & Quinn, 2005) and post-entry development process which investigates the adjustments retailers make as a response to the dynamics of the new operational environment after entry is relatively small (Frasquet, Dawson, & Molla, 2013; Molla', Fresquet, & Molina, 2011).

In the following section we present concepts of standardization, and adaptation to local conditions that are related to MNE retailers' post-entry choices. Next, we develop our main hypotheses about changing market entry commitments as are result of different post-entry experiences and changing uncertainty perception and then test them on a longitudinal sample of multinational retail firms. In the final section, we discuss the theoretical contributions of this study and identify fruitful future research directions.

2.2 Background

2.2.1 Initial Market Entry Choices for Standardization and Adaptation Related

Learning

Although there are significant economies of scale and scope advantages for multinational retail chains in replicating services in other countries, there are also costs and challenges involved with the knowledge transfer process that complements it (Jensen & Szulanski, 2004, Szulanski, 1996, Zander & Kogut, 1995). First, as any internationalization effort, these firms are required to deal with a number of hazards that the additional geographical, cultural and institutional distances introduce (Ambos & Ambos, 2009, Feinberg & Gupta, 2009) so that, crossing borders for replicating services possess several uncertainties for

them (Erramilli & Rao, 1990, Figueira et al, 2011, Johanson & Vahlne, 1977, Kostova, 1999).

Multiple distances involved in the process of cross-border replication of services have an effect on the management of knowledge that the multinational retail chains transfer between the headquarters and the subsidiaries as well. For these firms, the consistency of the replicated knowledge is very important, since they are faced with continuous pressures from their customers to offer the same quality of service across different contexts (Bradach, 1997; Grant, 1996, Winter, Szulanski, Ringov, & Jensen, 2012, Zander & Kogut, 1995). However, the integrity and value of the core service knowledge depreciates once it leaves the headquarters (Goodall & Roberts, 2003), and the higher the geographical, cultural and institutional distance between the headquarters and the locations where the services are replicated, the harder the knowledge transfer process becomes (Brannen, 2004, Ghemawat, 2001, Kostova, 1999, 2008, Nachum & Zaheer, 2005).

Mainly borrowing views from the Transaction Cost Economics (TCE), the entry-mode literature introduces structural integration and internalization as main mechanisms to manage uncertainties related to multiple distances involved with the internationalization process (Brouthers & Hennart, 2007, Buckley & Casson, 1998, Buckley, 2008, Figueira-de-Lemos et al, 2011). Ownership choices at market entry help the service multinationals to have control on the knowledge that is being transferred during the replication process (Dinur, Hamilton & Inkpen, 2009). MNEs decide on their level of commitments based on the uncertainty they are exposed to in their internationalization processes (Johanson & Vahlne, 1977). For example, if there is more uncertainty involved with operations in the

host country, the more structural integration the MNE wants to have on the process (Feinberg & Gupta, 2009).

On the other hand, accurate replication, only, is insufficient for these firms to achieve competitive advantage as their services could be easily imitated by others (Rivkin, 2001, Rivkin, 2003) or different contexts might require different levels of local responsiveness (Ghoshal & Bartlett, 1990; Szulanski & Jensen, 2006). Especially, firms that require intensive customer contact, need to ensure they have sufficiently adjusted their offerings to the customer group in the new geographical location (Capar & Kotabe, 2003; Helfat & Peteraf 2003). While choices on structural integration through different ownership levels can reduce the MNEs' exposure to some of the uncertainties involved in transferring standardized knowledge into new contexts, it has less impact on ones related to rapid changes in technology and consumer preferences in those contexts (Teece, 1986). Benito, Petersen & Welch (2011) suggest that internationalization not only pertains to appropriation of entry-modes, but also to their decisions regarding their non-financial assets in relation to user rights, customer relations, and value added activities. Accordingly, MNEs are required to align other parts of their business model other than ownership.

Positioning entails deciding on commitments on how to offer their services in the host countries (Cavusgil, Zou, & Naidu, 1993, Friesl & Larty, 2014; Wei & Lau, 2008, Zou & Cavusgil, 1996). For multinational retail chains, it's the choice of format types (Carpenter & Moore, 2006) since these format choices affect how they serve consumers and they are among the principal positioning factors within a new market entry (Goldman, 2001; Goldman, Ramaswami & Krieder, 2002).

For example, the multinational clothing retailer Mango underlined the importance of format choice for their success at host countries as follows:

“Flexibility of the format and capacity to adapt to the local needs maintaining the brand identity and being loyal to the Mango concept” (Ebeltoft, 2013)

In sum, we focus on two distinct types of commitments of multinational retail firms at host countries: ownership levels and format types. Figueira-de-Lemos et al (2011) introduce different types of commitments that are available to the MNEs at host-countries; differentiating between contractual based non-tangible commitments (ownership) and tangible commitments. From this perspective, while the format types involve physical investments and can be considered as tangible commitments, ownership related commitments are contractual based so they are more intangible commitments.

2.2.2 Dynamic Understanding of Standardization and Adaptation in Host Countries: Need to change the market entry decisions at post-entry

The fit between the firms’ strategies, their decisions and environmental contingencies are important for MNEs’ performance (Donaldson, 2001, Rugman, 2002, Slangen & Beugelsdijk, 2010). MNEs decide on different nature and level of different commitments at host countries in order to mitigate risks at the host countries (Figurea et al, 2011). Existing entry mode and international marketing studies provide a number of cases in which MNEs achieved a fit between their entry modes and initial positioning choices and the contingency factors performed better (Brouthers, Brouthers, & Werner, 1999).

On the other hand both MNEs and the host-country environments are prone to change together (McKelvey, 1997). As Van de Ven & Poole (1995) noted, “organizational designs are imperfect and incomplete and thus require continual reflection and monitoring to meet challenges from both the changing external environment and the inertia-prone internal environment (p.45).” For MNEs, any optimizing characteristics of what exists at the market entry must be understood as local and myopic (Van de Ven & Poole, 1995), since MNEs, their decisions and the environment surrounding are prone to change after their entry.

Similarly, the “bounded rationality” perspective underlies the existence of human cognitive limits (Cyert & March, 1963, Nelson & Winter, 1982) and contends that the incomplete information about means and ends leads to “satisficing” rather than choosing first best choices. The MNE host country environment is a good example where institutional voids, imperfect information, uncertainty and transaction costs affect decision making (Khanna & Pallepeu, 2013; Peng, 2003). Hence, MNEs that replicate their services to a new country can end up having made second-best choices regarding their commitments rather than the optimal ones that the extant theory predicts at the initial market entry (Brouthers, 2002, Brouthers & Hennart, 2007, Martin, 2013, Shaver, 1998).

Therefore, the initial fit between the initial conditions and MNEs’ commitments provides a static and limited picture for dealing with uncertainties in the host-countries and it is important to understand how MNEs achieve fit on a continuous fashion in host country contexts after their entry (Feinberg & Gupta, 2009; Hennart & Slangen, 2015; Verbeke, 2003). However, most of the existing studies typically ignore what happens after a market entry decision is made, and a dynamic understanding of when and why firms change these

initial decisions is missing (Blomstermo et al. 2005; Brouthers & Hennart, 2007). The literature is still silent on determinants of the change of operations resulting from suboptimal mode choices (Hennart & Slangen, 2015).

2.3 Theory and Hypotheses

2. 3.1 *Explaining Changing Commitments at post-entry: Effects of Continuous vs. Discrete Experiences*

Being flexible and customization of the business model after entry to a location is central for the success of multinational retail firms. For example, Media Markt succeeded in Spain after they adjusted their format to local needs and legal requirements. Similarly, the Body Shop succeeded in Germany upon decentralizing their governance structure. (Ebeltoft, 2013):

“Media Markt succeeded in Spain after local customization of their business model. The format was adjusted to local needs and legal requirements and managers of each store became responsible for the product portfolio, pricing, personnel and marketing for their store. This allowed the store manager to tailor the range of products they offer to the local context in which they operate and to guarantee a high level of customer service. The Body Shop succeeded in Germany upon decentralizing their marketing structure. The retailer remains a global brand with a centralized product development and retail strategy but the implementation of these strategies are managed and adapted as closely as possible to the customer in each local market. (Ebeltoft, 2013)”

The literature on evolutionary dynamics is a well-studied perspective to better explain the on-going change and how organizations respond to it in a process perspective. Nelson & Winter (1982) studied how firms responded to the change; believed the standard neoclassical theory could not adequately deal with the dis-equilibrium economics, that the Schumpeterian “creative destruction” introduced, and how Austrian perspective sees the world of competition. The evolutionary theory, by their definition, introduces a dynamic understanding how environment and organizations change together.

Kogut and Zander (1993) argue that at any point in time, given the current stock of knowledge of the MNE, managers will face the problem of deciding how to service a foreign market. Since host-country environments are not stable, but rather in a current transition and flux, it is important for MNEs to ensure the co-evolution of their knowledge flow network with the changing conditions (Cantwell et al, 2010). Such co-evolution of organizations is an outcome of the interplay between forces internal and external to organizational environment (Lewin et al. 1999) and lies at the heart of a dynamic view of organizations to explain how they adapt to the changing conditions (Nelson & Winter, 2002).

The organizational learning is at the core of the evolutionary process that accounts for the bounded rationality problem (Cyert & March, 1963; Nelson & Winter, 1982.) As a result of learning from the consequences of their prior actions and feedback from what organizations have tried (Nelson, 2002; Van de Ven & Poole, 1995), organizations can evolve and change their strategies. Moreover, the initial entry serves as a platform that gradually recombines the firm’s knowledge acquired in its home market with the learning

in the foreign market (Kogut & Zander, 1993). The initial market entry choices act as an “option” for future development of the MNEs and increased experiential learning can change MNEs’ uncertainty perceptions and push them to use their “options”. Every extra amount of additional feedback they gather from the host-country environment, may signal to some of the MNEs that they may want to expand their options (Kogut & Zander, 1993; 1995).

While organizations learn about host country conditions vicariously from others (Baum & Ingram, 1998; Baum, Li, & Usher, 2000; Cyert & March, 1963; Henisz & Delios, 2001; Kim & Miner, 2007), they can also learn from their own experiences (Ingram, 1997, Levinthal & Rerup, 2006, Simonin, 1997, Zollo & Winter, 2002), which are more directly related to internal evolution of MNEs. We focus on the experiences that MNEs gather at the focal conditions since only relevant and transferable experience are found to be related to have an effect on the internationalization decisions (Henisz & Delios, 200; Li, Qian & Yao, 2015).

The process view of internationalization (Johanson & Vahlne, 1977) argues that MNEs incrementally increase their commitments based on the knowledge they have at hand and the uncertainty they perceive. For MNEs, the uncertainty is directly proportional to the amount of experiential knowledge they have about the host-country locations and with increased levels knowledge they increase their commitments to lower the risks involved with internationalization (Figueira-de-Lemos, et al, 2011; Johanson & Vahlne, 2003). In the expansion of the process model, the knowledge is considered as the central force for opportunity recognition and exploitation (Johanson & Vahlne, 2009). Therefore, learning

is crucial for MNEs' evolutionary internationalization process after entry, since the changes in their knowledge levels have a direct effect on the type and level of commitments they make at the host-countries.

However, this perspective does not differentiate between different types of experiences at the host-countries. Studies on organizational learning suggest that it is achieved as a result of both accumulated experience, in which companies acquire knowledge through learning by doing (Arrow, 1962; Pfeffer & Sutton, 2000) and reinforcement learning which is based on the signals that firms receive when they compare their aspirational levels to the consequences of their prior actions (Argote & Greve, 2007, Argote, 2000, Levitt & March, 1988, Nelson, 2002, Van de Ven & Poole, 1995). While the first type of learning is considered as single-loop learning which occurs as a result of continuous accumulated experience and the reinforcement based learning is considered as double-loop learning that is more discrete in nature and occurs as a result of positive and negative experiences.

We present a dynamic and evolutionary model of post-entry decisions of multinational retail firms at the host countries (which occur as a result of learning from these different types of experiences (Benito et al., 2009; 2011; Cantwell et al., 2010, Figueira-de-Lemos et al, 2011, Johanson & Vahlne, 1977; 1999, Kogut & Zander, 1993). We suggest that MNEs' initial market entry decisions change as a result of their cumulative experiences, and the negative or positive performance experiences resulting from their initial market choices.

There have been a number of such cases where the MNEs engaged in equity changes at post-entry (see Meyer & Tran, 2006; Welch & Welch, 2009; Swoboda, Olejnik, &

Morschett, 2011). Puck, Holtbrügge, and Mohr (2009) showed that transaction cost related hazards can result in converting JV to wholly-owned subsidiary. Similarly, prior literature on post-entry changes also suggest that MNEs engage in mode combinations through which they change other aspects of their operations such as the format, in addition to the ownership choices at post entry (Benito et al., 2009; Petersen, Welch, & Nielsen, 2001). We extend these studies by suggesting that continuous vs. more discrete experience have different effects on the incremental process of deciding on the level of commitments at the host countries. While the continuous knowledge accumulation through experiential learning changes the uncertainty perceptions of multinational retail firms overtime, prompting them to re-position themselves, the discrete learning experiences as a result of initial positive vs. poor performance have both direct and indirect effects on the uncertainty-commitment choice relationship.

Next, using MNEs that replicate their services abroad as a context, we investigate those different cases of experiences, their effect on post-entry changes and performance effects of those post-entry changes.

2.3.2 MNE Accumulated Experience and Post-entry Changes

Accumulation of experience at the host countries increases MNEs' knowledge on internationalization process (Agarwal & Ramaswami, 1992; Figueira-de-Lemos et al, 2011). Prior research identified host-country experience as a major determinant of retail firms' internationalization decisions (Gripsrud & Benito, 2005). There are two types of knowledge related to the multinational retail firms' post-entry experience: the core knowledge which is contained in the retail brand package and is transferred from the HQ

to the local store, and the decentralized knowledge that the local stores have (Palmer, 2005; Palmer & Quinn, 2005). During the post-entry, while the outlet at the host country needs to develop its understanding of the service concept; simultaneously the headquarters needs to learn about local conditions under which the local outlet operates (Zander & Kogut 1995; Argote & Ingram 2000). The service firms such as retail chains need to consider specificities and complexities related to each knowledge source and manage the top-down and bottom-up knowledge flows continuously.

The post-entry experience can engage multinational retail firms to search for different peaks on the set of fitness landscapes (Anderson, 1999) Since the co-evolutionary process is an attempt to find other peaks, among different situations (Lewin et al, 1999), rather than looking for a single fit, organizations then can engage in adaptive organizational search based on the changing conditions and accumulated experience (Levinthal & March, 1986). Hence, these firms' gradually increased knowledge about the host country differences can act as an initial dynamic for evolution (Benito et al, 2009; Cantwell et al, 2009).

In the post-entry period, multinational retail firms will develop their knowledge on the local dynamics as they gain experience (Benito et al, 2010; Gielens & Dekimpe, 2001) and as they gather more feedback from the location of the focal outlet, they will perceive host-country countries less dissimilar. (Chang & Rosenzweig, 2001, Zahra, Ireland, & Hitt, 2000). The changing conditions at the host countries make once optimal choices non-optimal and push organizations to learn through the trial and error of experimental search and exploration (Nelson & Winter, 2003). Since, continuous organizational learning is achieved through careful choice of firm boundaries (Brusoni & Gavetti, 2002; Macher,

2006; March, 1991), these firms will re-organize to align better for standardization and adaptation. As a result, some multinational retail firms might feel the pressure to change their initial positioning choices, post-entry. Hence, we argue that the accumulated experience at the host countries will prompt the multinational retail firms to change their initial ownership and format decisions at post-entry.

We are interested in the direction of the change in ownership and format choices at post-entry. As subsidiaries evolve, commitments may be decreased as well as increased (Santangelo & Meyer, 2011). As Figurea-de Lemos et al, (2011) suggests, "...increased amount of market knowledge, mostly acquired through experiential learning, decreases contingent uncertainty (pg.145)" As MNEs learn more about the host country locations, they might be willingly to increase their ownership (Erramilli & Rao, 1990, Erramilli & Rao, 1993; Johanson & Vahlne, 1977; Pauwels & Matthysens, 2004; Puck et al, 2009) and internalize their operations more, since they think that the risk related to the uncertainty is reduced overtime. (Benito et al, 2011; Figurea-de Lemos et al, 2011). Therefore, as multinational retail firms gather more experience at the host countries, they will be more likely to increase their initial ownership at post-entry.

H1a: Accumulated experience at host country fosters increases in ownership percentage at post-entry

Similarly, increased knowledge about the host country locations can also result in changes in multinational retail firms' commitment choices, such as the formats offered at the host countries (Carpenter & Moore, 2006). Studies in international retailing showed positive performance effects of differentiation of offerings (product) and medium to reach

customers (place) to adapt better to the host-country customers (Goldman, 2001). With accumulated experience at the host countries, multinational retail firms can experiment with new types of format offerings to serve different segments of customers (Palmer & Quinn, 2005). Therefore we argue that as multinational retail firms gather more experience at the host countries, they will be more likely to increase the number of format offers at post-entry:

H1b: Accumulated experience at host country fosters increases in number of formats introduced at post-entry

2.3.3 Indirect Effect of Negative Initial Performance Experience on Changing Entry Decisions

As Levinthal and Rerup (2006) captured it, “outcomes classified as exceeding the aspirations are evaluated as a success and are reinforced in subsequent periods, while outcomes not meeting the aspiration are judged as failures (pg.508).” Prior studies found that culturally insensitive positioning of the services in the host countries results in a negative consumer image of the MNE and results in a market share loss (Goldman, Ramaswami & Krieder, 2002). Especially, for MNEs that are replicating their services to different countries, incorrect choices affecting the standardization vs. adaptation of the knowledge being transferred yields reduced profitability and slower growth (Jensen & Szulanski, 2006). Hence, the misfit between the initial choices and the poor performance resulting from them can be evaluated as “organizational failures,” and since they fall below the aspiration levels, such experiences are transmitted as negative signals to the MNE headquarters (Brouthers, 2002).

The literature on sense-making suggests that negative signals have a higher chance to raise attention and to be acted upon with mindfulness (Weick & Roberts, 1993). Negative outcomes push firms to engage in what is called as problemistic search, looking for alternative solutions among fitness landscapes (Gavetti & Levinthal, 2000). Problemistic search is “is stimulated by a problem and is directed toward finding a solution to that problem” (Cyert & March 1963, p. 121) and induces action taking and variety-generating mechanism to initiate change and adapting to change process resulting to the coevolution of the organizations (Nelson, Winter & Sidney, 1982, Nickerson & Zenger, 2004, Nickerson, 2003). Hence, initial poor performance at the host countries can push the multinational retail firms to search for new solutions and spark the evolutionary process of managing operations in the host countries in the post entry period.

The last step in the problemistic search is to decide how to organize a solution that simultaneously considers efficiency concerns and appropriation hazards (Macher, 2006, Nickerson & Zenger, 2004). In the case of post-entry change on initial market decisions, Chung & Beamish (2010), find that IJVs tend to change their initial ownership control decisions after a negative performance. They argue that this negative signal acts as a change triggering point that initiates an adaptive structural change on control relations and control structures (Donaldson, 1987, Donaldson, 2001, Inkpen & Beamish, 1997). Similarly, studies on mode-dynamics found out that drastic performance changes result in MNEs to change their entry strategies (Ellis, 2005; Swodeba et al, 2011). The negative performance can be perceived by the MNE HQ as a dissatisfaction with the current modes (Calof & Beamish, 1995; Gomes-Casseres, 1987) and push MNEs to revisit their initial choices at

the market entry in addition to the experiential learning (Benito et al, 2010; Hennart & Slangen, 2015; Swodeba et al, 2011).

We argue that after the initial poor performance, multinational retail firms might change their initial choices in the hope that such changes will help them attain a new firm boundary and positioning point at the host countries. When poor initial performance is signaled back to the HQ, this can initiate the micro-evolution within the retail subsidiary network, on top of the continuous feedback from accumulated experience on post-entry changes. As a result initial, poor performance experience can indirectly trigger the changes in the ownership and format for aim to fix the initial “mis-aligned” position and to align better to the evolving host country environment at post-entry.

Johanson & Vahlne (2009) show that commitment may decline if performance and prospects are not sufficiently promising. The initial performance that falls below the aspirations can ward off the MNE HQ to engage in more commitments at the host country, affecting the post-entry decisions after the experiential learning (Wiseman & Gomez - Mehija, 1998). The negative signal can be perceived as increased uncertainty at the host countries, under which MNEs tend to choose entry-modes with less ownership (Figurea-de-Lemos et al., 2011). Building on these notions, we posit that the initial poor performance experience will *temper* the positive effect of accumulated experience on increasing ownership at post-entry. Hence, we claim that poor initial performance experience will negatively moderate the positive relationship of accumulated experience and post-entry ownership change:

H2a: Poor initial performance experience of the MNE retail outlet will negatively moderate the effect of host country experience on increasing ownership at post-entry.

On the other hand, the existing studies showed that in the case of increasing uncertainty, the MNEs often respond by diversification in their product offerings (Kim Hwang, & Burgers, 1993; Rugman, 1976). In the case for the multinational retail firms, the initial poor performance can signal more uncertainty to the HQ and it can prompt them to look ways for re-adaptation through different format choices (Benito et al, 2010; Chung & Beamish, 2010; Hennart & Slangen, 2015; Swodeba et al, 2011). Thus, we argue that the initial negative performance experience will *reinforce* the relationship between the experience and number of formats and turn it to be more positive.

H2b: Poor initial performance experience of the retail outlet will positively moderate the effect of host country experience on increasing format introductions at post-entry.

2.3.4 Indirect Effect of Higher Initial Performance Experience on Changing Entry Decisions at Post-entry

It's hard to define success. The prior literature defines it as experiences with absence of poor performance in which organizations exceeded the aspirations (Levinthal & Rerup, 2006). We focus on such cases of higher initial performance, where the MNEs did comparatively better than their prior internationalization experiences.

If the MNE HQ makes sense of the initial positive signal from the host country, this can create a conducive environment to take more risks and increase commitments at the host-countries (Figurea-de Lemos et al, 2011). Contrary to case with the poor initial

performance, higher initial performance experience can this time *reinforce* the positive relationship between accumulated experience and increase in ownership:

H3a: In the absence of poor initial performance, higher initial performance experience of the retail outlet will positively moderate the effect of host country experience on increasing ownership at post-entry.

On the other hand, studies showed that it is often harder for firms to learn from successes and be motivated to change compared to negative outcomes (Argote & Greve, 2007, Greve, 1998, Levinthal & Rerup, 2006, Levinthal & March, 1993), so that understanding what drives post-entry changes in such cases is a challenging task. Organizations like stability and in the absence of a negative signal from the environment, they usually tend to satisfice with their prior decisions (Cyert & March, 1963). During times of stability, prior decisions turn into routines that are repetitive patterns of activity that are rooted as “genes” in the roots of the organizations and enable smooth functioning of the organization (Nelson & Winter, 1982).

Similarly, positive consequences can speed up the process that prior firm actions turn into routines (Cyert & March, 1963; March, 2010; Levitt & March, 1988) to ensure strategic persistence (Lant, Milliken, & Batra, 1992, Miller & Chen, 1994, Miller, Lant, Milliken, & Kom, 1996) and firms can develop rigid organizational structures (Hannan & Freeman, 1984). As a result, successful experiences can turn into different types of organizational inertia such as competency traps or success traps (Leonard - Barton, 1992, Levinthal & March, 1993, Levitt & March, 1988), which in turn, can affect organizations’ performance

detrimentally if they ignore the implications of major environmental changes (Audia, Locke, & Smith, 2000, Tripsas & Gavetti, 2000).

From an evolutionary perspective, this type of organizational behavior creates “a culture of overconfidence and vulnerability (Rerup, 2009; pg. 882), and it can prevent problemistic search that leads to isolation in knowledge transfer strategies undertaken by MNEs in the host countries (Monteiro, Arvidsson, & Birkinshaw, 2008). Such path-dependency can prevent MNEs from changing their initial choices, since, organizations are expected to behave in the future according to the routines they have employed in the past (Nelson & Winter, 1982). Moreover, the lack of a negative signal can result in the uncertainty perception of the MNEs to stay unchanged (Figurea-de Lemos et al, 2011).

In the absence of poor initial performance, higher initial performance experience of the retail outlet curtails changes in format choices at post-entry at host countries. When MNE HQ perceives less uncertainty, the multinational retail firm might choose further standardization in its offerings with the hope that will result in economies of scale across its network of subsidiaries. Therefore, we argue that the positive initial performance will *temper* the relationship between accumulated experience and increases in format introductions at the post-entry:

H3b: In the absence of poor initial performance, higher initial performance of the retail outlet will negatively moderate the effect of host country experience on increasing format introductions at post-entry.

2.4 Effect of Post-entry Changes on MNE Survival

Variation is another central element of evolution and increases chances of selection (Nelson & Winter, 1982). As portfolio diversification helps firms to spread downside risks, organizations with more variations can end up performing better if they can find the appropriate boundary and positioning choices for their survival. Reorganization of initial organizational choices may represent an attempt to regain fit and to achieve profitable operations in the host countries (Chung & Beamish, 2010). Literature provides instances of firms which were able to learn from their experiences and as a result, performed better (Staats, & Gino, 2013, Levinthal & Rerup, 2006, Madsen, 2010, Mukridakis, 1991, Rerup, 2005). Benito et al. (2010) shows that changing the entry strategies diminishes the suboptimality of the initial choices at market entry.

For multinational retail firms, correcting the mis-aligned choices for ownership and positioning can help them better organize their efforts towards deciding on the degree of standardization vs. adaptation at host countries. Re-aligning entry-mode according these evolved perceptions of the MNEs process will help them ensure more efficient boundaries in managing standardization and adaptation, post entry (Jensen & Szulanski, 2006, Jensen, 2008). Similarly, the literature shows positive effects of being able to tap into local knowledge for firms that replicate their operations abroad (Friesl & Larty, 2012; Helfat & Peteraf 2003). Changing the format allows multinational retail firms to re-position themselves better in the foreign locations and better aligning to the local condition increases their effectiveness in sourcing more knowledge from external networks with higher quality.

Verbeke (2003) suggests that “the firm’s governance structure through which it efficiently links the firm-specific competence base with the best modes to organize particular transactions, especially as compared to rival companies, leads to superior performance. (p.895).” Hence, we argue that if multinational retail firms update both their entry mode and the entry format decisions, they will perform better as they would benefit from externalities related to ambidexterity (Gibson & Birkinshaw, 2004; March, 1991).

H4: *Controlling for the initial performance, multinational retail chains that change both their initial ownership and format choices at post-entry will be more likely to survive at those host country locations.*

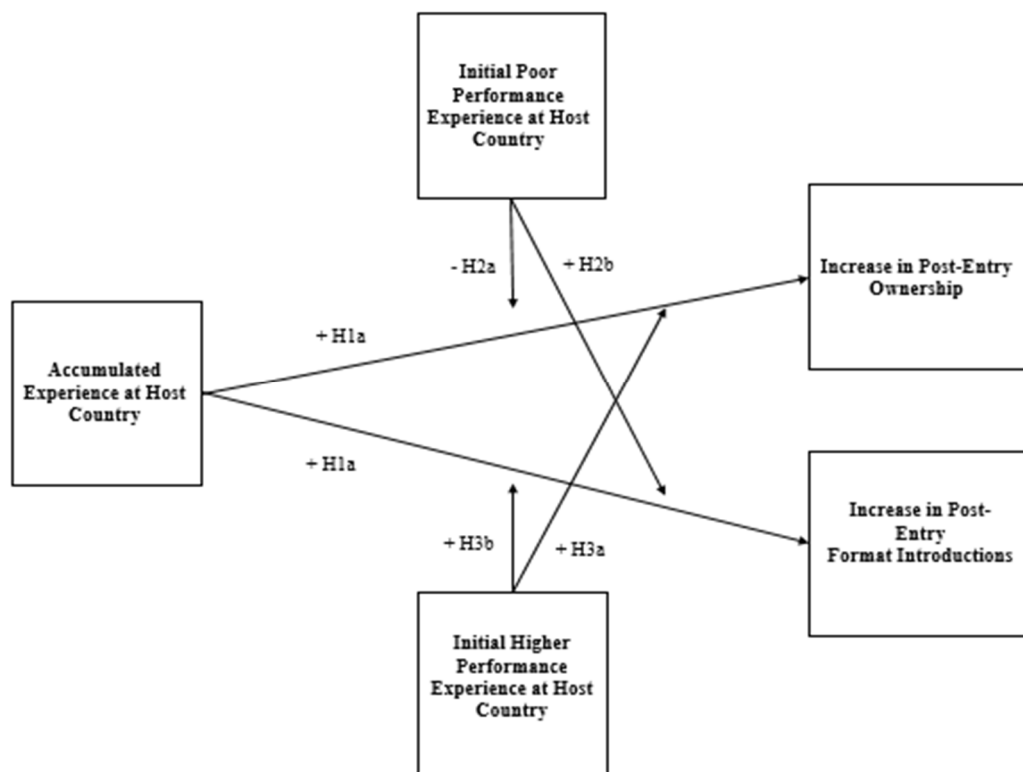


Figure 2.1. Model of Accumulated Experience vs. Initial Performance Experience and Increase in Governance Related Commitments vs. Positioning Commitments

2.5 Methods

2.5.1 Data and Sample

Our focus is on Multinational Retail Industry as it provides us a good context to investigate the process of replicating services to other countries. Many firms such as MNE retail chains grow their operations by simply replicating their home country routines and practices in foreign locations (Dunning, 1988; Hymer, 1976; Porter, 1995; Teece, 1996). The multinational retailing industry is highly consolidated; the top 10 firms account for more than 80% of the international sales (Deloitte, 2012).

Our initial sample consists of Walmart and Carrefour's international operations. We chose both companies as they were similar in size (No.1 and No.2 in global retail market) and international experience (www.euromonitor.com). We investigate each company-foreign outlet location, considering it as a "dyad" and track their operations from their entry (earliest 1975) to 2012. This required us to manually go-through 5000 pages of annual reports of the companies and analyze articles from industry magazines for each company-location dyad to have a better understanding of their operations in each location. We cross-checked our findings with data available through Mergent Online and CapitalIQ databases. The final sample consists of 42 company location dyads, and longitudinally tracking the operation at those countries results in 524 observations in total. Our method of obtaining the data accounts for potential recall biases involved with potential surveys, asking for post-entry commitments (Hennart & Slangen, 2015).

TABLE 2.1 Descriptive Statistics

Variable	Obs	Mean	Std. Dev.	Min	Max
Increase in Ownership	501	13.49721	21.55071	-41.8	94
Increase in # of Formats	512	0.722656	0.941142	0	3
Initial poor performance	525	0.40381	0.491128	0	1
Initial higher performance	527	0.935484	0.245904	0	1
Cum. international Experience	525	172.261	116.5415	0	496
Experience at focal country	526	8.492395	6.937197	0	37
Exp* Initial Poor Performance	525	3.131429	5.599879	0	36
Exp* Initial Higher Performance	523	5.365201	7.095037	0	37
Survive	525	.895238	0.306539	0	1
Mode of entry	524	2.990458	1.466615	1	5
Format at entry	524	4.173664	1.505374	1	5
Revenue	525	138520.2	123503.5	13302.4	421849
Netsquare (000)m2	496	5578.526	12813.38	0	91488
Increase in Sales Area (000)m2	464	0.275833	0.771994	-0.96029	11.1367
Financial Slack	525	0.899733	0.270347	0.612847	2
Economic Distance (log)	526	1.439226	0.11968	-0.2596	1.547821
Geographic Distance (log)	525	1.222	0.131857	0.900349	1.378341
Cultural Distance (log)	507	0.083757	0.317339	-0.58644	0.591964
Institutional Distance	425	3.117542	1.110272	-3.78243	4.377922

2.5.2 Measures:

Accumulated Experience of International Outlets

Based on the prior literature, we measure accumulated experience of the multinational retail firm in a location by calculating the year of operation of the subsidiary in a focal country.

Accumulated Experience: year t – focal country year of market entry

Initial Performance of International Outlets

We measure prior poor initial performance similar to the Chung & Beamish (2010)'s proxy for the initial performance of International Equity Joint Ventures (IEJV). Different than their study, since we do not have the perceptual performance measures reported by the managers as they do, instead we develop a more fine-grained aspirational proxy for poor performance. We measure the initial performance of each company-location dyads based on their ability to grow their outlet portfolio (Szulanski, 2003). The net increase in sales area gives us a rich picture of firms' ability to increase their portfolio and their market share in the short-run (Ailawadi, 2001; Banker, Potter, & Srinivasan, 2000; Lewis & Thomas, 1990; Rust, 1993).

We examine multinational retail firms' prior international expansion and calculate the average of increase in sales area in those other locations after 2 years of entry (Chung & Beamish, 2010). Hence, it provides us a simplified version of HQ's comparison of focal MNE's initial performance in new internationalization effort to its prior average performance in other locations. We use a nominal measure of the initial performance as

we accept the performance signals as more discrete compared to the accumulated experience.

If the focal initial performance is worse than the average of the similar experiences, we code it as “1” for “poor performance experience.” Otherwise we accept it as higher initial performance experience for the MNE and code it as “0”.

We used this measure as independent variable for investigating the effect of prior performance experience at $(t-1)$ on MNEs’ post-entry ownership and format choices (Chung & Beamish, 2010) for two different samples with poor and higher initial performance experience cases.

Poor initial performance experience = 1 if avg performance at focal country (first 2 years) $firm_i < \text{avg prior performance in other locations (first 2 years) } firm_i$; otherwise 0

Higher initial performance experience = 0 if avg performance at focal country (first 2 years) $firm_i < \text{avg prior performance in other locations (first 2 years) } firm_i$; otherwise 1

Change in Organizational Boundary & Change of Retailing Format:

Changes in the ownership levels and chosen format served as both dependent and independent variables. We measure change in ownership by tracking the amount of ownership that retail firms report for their operations in each foreign location (Chung & Beamish, 2010). We consider the initial ownership percentage as reference and calculate increases and decreases in ownership for each year:

Increase in Ownership_t: $\text{ownership \%}_t - \text{ownership \%}_{t-1}$

Change in Ownership_t : $\text{abs}(\text{ownership \%}_t - \text{ownership \%}_{t-1})$

The retailing literature classifies different formats available to the multinational retail chains under three main types: Single, Hybrid and Multiple. A single format means serving consumers through one type of retail outlet, either being a hypermarket, a small outlet or a discount store, a hybrid format means serving consumers under two retail outlet types, and a multiple format means having the three different types of outlets at the same time.

We consider formats available to the MNEs as Single, Hybrid and Multiple (Picot-Coupey, 2006). Similar to the organizational boundary change measure, we consider the initial format choice as a reference point and track if a change was made to the retailing format for each year. Then we cumulatively calculate number of format changes for each year.

Increase in Format Introduced_t : # of Format offered_t - # of Format offered_{t-1}

Increase in Format_t: # of cumulative format changes_t

Survival of Multinational Retail Firms:

We measure long term longevity of the MNE retail chains at host country locations by looking at whether they exited or not during the time span of our study (Eckert & West, 2007; Kosova & Lafontaine, 2010).

MNE Post-entry performance = 1 if firm_i is actively operating at the host-country at time_t; otherwise 0

Controls:

We control for both firm-specific and non-firm specific factors. The entry-mode and learning literature stress the effects of dissimilarity between the HQ and the foreign operations' location (Benito et al, 2009). Therefore, we control for cultural, economic, institutional and geographic distance for each company-location dyad. The data for these controls are derived from World Bank Indicators, and Hofstede's Cultural Distance Measures. We calculate cultural distance for each location based on Hofstede's cultural dimensions. we only focused only on the first 4 dimensions because for most of the countries in our sample, only 4 dimensions were provided, that are Power distance, Individualism, Masculinity / Femininity and Uncertainty avoidance (UAI) (Hofstede, 2001). In order to visualize the data of the first 4 dimensions, we calculated a distance matrix for all populations of the countries (N=166) and came up with an index similar to the Kogut–Singh index (Kogut and Singh, 1988). For economic and institutional distance measures, we used World Bank's indicators and for each company-location dyad, we measured the difference between the ranking indicators for HQ and the foreign location for each year (Benito, Pedersen & Petersen, 2005). The average of these differences provided us a comparable measure for economic and institutional distance. We measured the geographic distance using a Geographic Information System (GIS) software, that calculates the latitude and longitude based distance between the HQ and the foreign outlet country.

For firm specific factors, we control for the MNE size (revenue), financial slack, the cumulative years of international experience, prior changes, current sales area at the host country, and its increase or decrease in sales area. We also control for the initial entry-

mode and measure it under an ordinal variable that contains JV, Franchising, Acquisition, Majority-Owned and Wholly-Owned modes. We control for the initial format at entry and measure it with an ordinal variable that contains Single, Hybrid and Multiple options.

2.5.3 Estimation

We performed VIF tests on the variables for multicollinearity, and transformed some of our control variables to log values. The correlations among our explanatory variables were not high and significant.

Since firms first choose how to enter a market and these choices correlate with their later choices and post-entry performance, we use a 2-step Heckman Selection model to account for possible sample selection endogeneity problems. Forming our model based on the prior literature on entry mode literature, we let our distance and firm specific factors first decide mode of entry and then run a regression on the effect of our proposed variables on the post-entry choices and performance of retail firms in each company-location dyad, using Mode and Format of entry as instruments.

Using ordinary least squares (OLS) to estimate panel data can result in biased estimates because of unobserved heterogeneity (Pindyck & Rubinfeld, 1998), as a result, we lagged our IVs to for reverse-causality concerns. Given the lagged nature of the dependent variable, the unobserved panel-level effects can be correlated with the lagged dependent variable, which in turn might result in the standard estimations produced by the fixed effect models to be inconsistent (Arellano & Bond, 1991). Accordingly, we used Arellano-Bond GMM estimators with the STATA 12.0 command, *xtabond2*, due to potential endogeneity

issue and hardship in finding strong instruments and biases that such weak instruments can introduce (Holtz-Eakin, Newey & Rosen, 1988; Roodman, 2009). Xtabond2 enables us to use the estimations of the dependent variable and the first difference of all the exogenous variables as standard instruments in addition to the mode of entry and format at entry estimations we had derived in the first stage. Specifically, we used the lagged-dependent variable as part of our independent variables, which is often done with the GMM approach. Consistent with Roodman (2009), we used max 1-year lag for instrumenting the lagged dependent variable. Finally, we used the two step estimator with robust option which matches the one- and two-step results in Arellano and Bond (1991). For testing the effect of post-entry changes on post-entry performance, we use a random effect probit model with robust standard errors.

2.5.4 Results

Table 2.2 reports the result of the first-step Heckman selection model. In line with the prior literature, we found negative and significant effects on choosing more ownership and multiple format based entry decisions of cultural, institutional and geographical distance, in line with the existing literature. We found a positive and significant effect of the economic distance and international experience.

TABLE 2.2 First-Stage Regressions

	(1) Mode of Entry	(2) Format at Entry
Total Revenues	-0.539* (-6.16)	-0.324* (-3.11)
Slack	0.506+ (1.79)	-0.459 (-1.26)
International Experience	0.511* (2.64)	-0.533+ (-1.93)
CulturalDistance	0.0216 (0.13)	-0.647* (-3.11)
GeographicDistance	-0.453* (-2.80)	-0.361+ (-1.83)
EconomicDistance	1.433* (4.69)	1.444* (4.14)
InstitutionalDistance	-0.200* (-3.41)	0.0834 (1.17)
<i>N</i>	419	420

We present the results of the direct effect of accumulated experience and moderating effect of the initial performance in Table 2.3. As Model 1 and Model 2 indicate, experience at host country is positively related to increases in ownership and increases in number of formats MNEs introduce at post-entry. The other models also shows that the significant positive effect of experience at the host country on the post entry ownership and format choices stay significant. Therefore, we found support for H1a and H1b.

TABLE 2.3 Second-Stage Regressions, Direct Effects of Experience, and Moderating Effects of Failure and Non-failure on Experience and Post Entry Changes Relationship

	(1)	(2)	(3)	(4)	(5)	(6)
	Increase in Ownership	Increase in Format	Increase in Ownership	Increase in # of Formats	Increase in Ownership	Increase in # of Formats
Accumulated Experience	0.484** (2.79)	0.0420*** (3.52)	0.716* (2.21)	0.0434*** (3.84)	0.752+ (1.92)	0.0544*** (4.17)
Initial Poor Performance			4.905* (2.06)	-0.0256 (-0.44)		
Higher Initial Performance					0.0907 (0.05)	-0.0868 (-1.49)
Exp*Poor Performance			-0.219* (-1.96)	0.0118** (3.11)		
Exp*Higher Performance					-0.0398 (-0.73)	-0.0104*** (-3.50)
MNE Revenue	-0.0259 (-1.72)	0.00120 (1.06)	-0.0318 (-1.72)	0.00136 (1.06)	-0.0313 (-1.37)	0.00137 (1.16)
Sales Area at Host Country	-0.0359 (-0.35)	-0.00991* (-2.42)	-0.00338 (-0.23)	-0.0106* (-2.50)	-0.0136 (-0.09)	-0.0108* (-2.57)
Increase in Sales Area	0.284 (0.06)	-0.373 (-1.77)	-0.477* (-2.05)	0.0105 (0.97)	-0.500* (-2.11)	0.0109 (1.01)
Ownership Prior Change	49.10* (2.08)	-2.738 (-1.43)	-1.945 (-1.60)		-1.772 (-1.51)	
Financial Slack	-2.636 (-0.25)	1.680* (2.01)	-0.236 (-0.05)	-0.346 (-1.66)	0.940 (0.17)	-0.353 (-1.69)
Econ Distance	-12.85** (-2.63)	-0.324 (-1.93)	107.8** (3.09)	-2.470 (-1.31)	98.25** (2.99)	-2.446 (-1.36)
Geog Distance	0.817 (0.56)	0.111 (1.45)	-21.29 (-1.55)	1.555* (2.03)	-29.38 (-1.75)	1.583* (2.01)
Cultural Distance	0.000690 (0.06)	-0.000656 (-1.50)	-10.75 (-1.38)	-0.310 (-1.88)	-9.452 (-1.27)	-0.314 (-1.92)
Inst Distance	0.817 (0.56)	0.111 (1.45)	1.535 (0.89)	0.113 (1.39)	1.881 (1.06)	0.111 (1.39)
Int Experience	0.000690 (0.06)	-0.000656 (-1.50)	-0.00472 (-0.37)	-0.000763 (-1.70)	-0.00278 (-0.21)	-0.000760 (-1.74)
Mode at Entry	-25.46* (-2.29)	0.729 (0.87)	-33.51* (-2.22)	0.644 (0.77)		0.655 (0.83)
Format at Entry	-0.126 (-0.11)	0.0659 (0.80)	-11.00*** (-4.86)	0.0513 (0.74)	-9.715*** (-5.20)	0.0437 (0.59)
Increase in Format	-3.025 (-1.44)			0.429*** (10.09)		0.425*** (9.90)
Increase in Ownership		0.429*** (7.32)	0.417** (3.17)		0.401** (2.61)	
N	267	265	267	267	265	267

t statistics in parentheses

+ $p < 0.1$ * $p < 0.05$, ** $p < 0.01$, *** $p < 0.001$

We test the effect of initial performance on fostering or curtailing the changes in ownership or formats at post-entry in Models 3, 4, 5 and 6 in Table 2.3. These models investigate the moderating effects of initial performance on the relationship between the experiential learning and post-entry changes. As Model 3 indicates the moderating variable Exp*Poor Performance had a negative and statistically significant effect on increase of ownership percentages at post-entry, supporting H2a. As Model 4 indicates this moderating variable has a positive and statistically significant effect on increase in number of formats introduced at post-entry, which also supports H2b.

Regarding the moderation of higher initial performance on experiential learning and post-entry changes, as Models 5 indicates although the coefficients are in the direction as we had hypothesized, we failed to find a statistically meaningful relationship between the Exp*Positive Performance and increase of ownership at post-entry (H3a). However, as Model 6 indicates, we found a negative and statistically significant relationship for this moderation, indicating that higher initial performance decreases the positive effect of experiential learning on increasing format choices at post-entry, thus supporting H3b.

Finally, we test the effect of post-entry changes on post-entry longevity in Table 2.4. As the Model 7, Table 2.6 indicates, we only find a positive and significant effect of change in ownership at post-entry on post-entry survival only, which partially supports H4.

TABLE 2.4 Effect of Post-entry Changes on MNE survival at Host Country

	(1) Survival of MNE at Host Country
Change in Format	-1.070 (-1.59)
Change of Ownership	1.392* (2.05)
International Experience	0.00372 (0.58)
Experience at Host Country	0.0172 (0.36)
Initial Performance	-0.176 (-0.58)
Sales Area at Host Country	-0.0000170 (-0.57)
Revenues	-1.106 (-1.06)
Financial Slack	3.468 (1.28)
Cultural Distance	4.295 (1.45)
Econ Distance	-0.844 (-0.08)
Inst Distance	-1.399 (-1.36)
Mode at Entry	-0.0127 (-0.06)
Format at Entry	0.0381 (0.18)
_cons	15.69 (0.99)
<i>N</i>	276

t statistics in parentheses

+ $p < 0.1$ * $p < 0.05$, ** $p < 0.01$, *** $p < 0.001$

2.6 Discussion

In this paper we investigated dynamics of post-entry commitments by multinational retail firms for managing risks related to cross border replication of their services. Building our argument on the co-evolutionary view of the MNEs, (Cantwell et al, 2009; Kogut & Zander, 1993), which suggest that the initial market entry choices are suboptimal and are prone to change at post-entry, and process view of internationalization that introduces a dynamic understanding of level and nature of commitments based on the experiential knowledge MNEs gather (Figurea-de Lemos et al, 2011; Johanson & Johanson, 2009), we presented the complete internationalization histories of multinational retail firms from their first entry to until their exit in different locations, by tracking the changes in their performance, ownership and format choices. Different from the prior studies, we first disentangled the post-entry experiences into two types: MNEs' accumulated experience at host countries that send more continuous signals to the HQ and the initial performance experience that sends signals that are one-time thus more discrete to the HQ. We then assessed how each different experience lead to changes in uncertainty perceptions of these firms at those locations and then how they affected the type and nature of commitments there. Our approach contributes to lacuna within the entry-mode literature to investigate whether MNEs take into account the ex post performance of prior choices and learn from them (Hennart & Slangen, 2015).

Our results indicate that the continuous accumulated experience at the host countries foster changes in ownership and format at post-entry, specifically resulting in an increase in ownership and number of different formats introduced in that location. We found that the

initial poor performance experience also fosters changes in ownership and format choices at post-entry, indirectly. However, this initial negative signal transmitted to the HQ introduce higher uncertainty for the multinational retail firms at post-entry and affect the positive relationship between accumulated experience and increases in ownership negatively, while strengthening the positive relationship between accumulated experience and number of formats introduced. We calculated the margins for these moderated relationships and graphed them as margin-plots (Figure 3 & Figure 4).

As can be seen from the Figure 2.2, higher accumulated experience levels are associated for bigger increases in ownership increase at post-entry. The two lines represent the poor and higher initial performance experiences. The poor initial performance line's slope is less steep than the initial higher performance line, indicating the negative moderation of poor performance the relationship between accumulated experience and increases in ownership levels at post-entry.

The Figure 2.3 represents the same relationship on increases in post-entry format introductions. Again the two lines represent the poor and higher initial performance experiences at host countries. This time, the slope of poor initial performance line is steeper than the higher initial performance line, suggesting that initial poor performance foster effect of accumulated experience on diversification of the retail format at post-entry. The initial higher performance at the other hand, curtail changes in ownership and format choices at post-entry, but not leading to any significant relationship for the direction of ownership and format introductions.

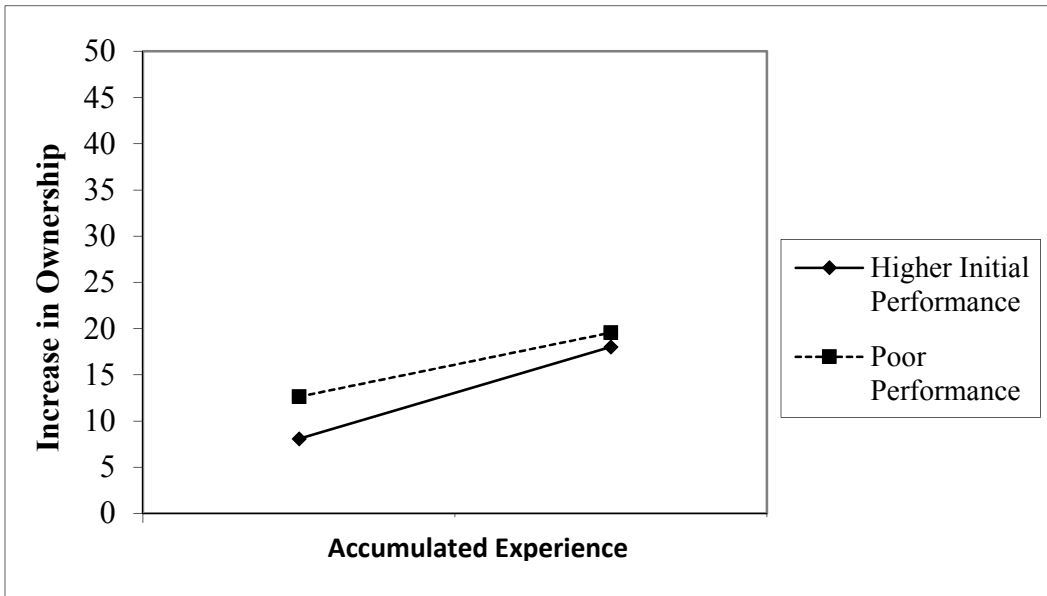


Figure 2.2: Interaction between Poor Initial Performance and Accumulated Experience on Increases in Ownership Levels at Post-Entry

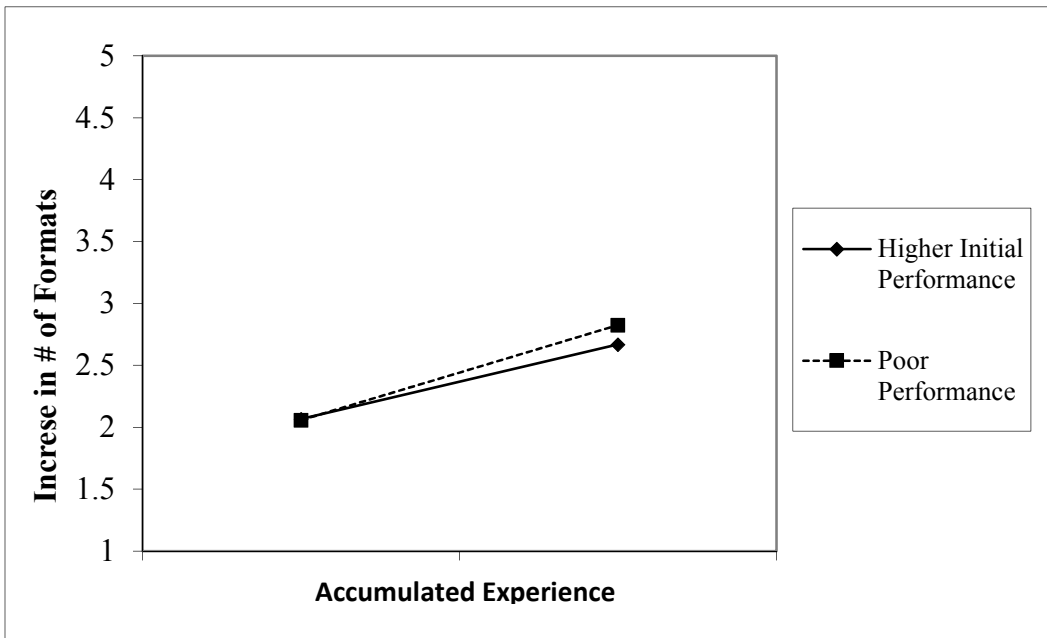


Figure 2.3: Interaction between Poor Initial Performance and Accumulated Experience on Increases in Number of Formats Introduced at Post-Entry

2.7 Conclusion

Studies point out that replication of services abroad requires a more dynamic perspective (Blomstermo, et al, 2005). We built our arguments on the co- evolutionary view of the MNE which suggests that as the environments at host countries evolve, so do the firms that are operating in it. These studies introduce firms' increasing levels of experiential knowledge about a location as an important trigger for the initiation of the evolutionary change (Cantwell et al, 2009). Similarly, the process view of the internationalization considers that MNEs' decide on the level of commitments by taking into consideration the uncertainty they perceive as a result of their prior internationalization experiences (Figurea- de Lemos et al, 2011). As Hennart and Slangen (2015) state: "So far we lack knowledge of the determinants of the longevity of foreign operations resulting from suboptimal mode choices, and of the factors determining whether such operations will be dissolved or undergo a governance change. (pg.118)" We extend the existing studies and answer calls from the literature by introducing how different types of experiences affect commitments made at the same country (Li et al, 2015), resulting in co-evolution of ownership and positioning choices according to changing conditions and uncertainty levels at the host countries. Hence, we introduce a more dynamic understanding of firms that replicate their services abroad, where they co-evolve to deliver standardization and adaptation in a continuous fashion.

Most of the existing studies present the multiple distances between the home and the host countries as static, and so are the suggested MNE strategies at the market entry. On the other hand, distance is indeed a much more complex concept as pointed out recently by

Williams & Gregoire (2014). The continuous nature of distance is as a result of the fact that the distances involved in the internationalization are perceptual, since their effect on uncertainty change as a result of the knowledge MNEs have at the moment (Figurea-de Lemos, et al, 2011; Zhou & Guillén, 2014). Similarly, the existing strategies on entry choices fall short in managing other uncertainties that emerge after MNEs enter to a location (Feinberg & Gupta, 2009). Our story on co-evolution of firm commitments introduce a dynamic perspective to manage uncertainties in a continuous fashion, after the initial entry. We show how MNEs incrementally change different commitments as a result of their accumulated knowledge and the consequences of their initial choices at post-entry to account for the MNEs' changing perceptions of distance and the uncertainty related to it.

Our empirical study presents interesting findings for the MNE managers as well. It shows that that the experiences that MNEs gather at host countries can differ in nature and also in the way they transmitted as signals to the HQ. For example, MNEs accumulation of knowledge at the host countries is a continuous signal, while the initial performance outcomes can be perceived as more discrete signals by the HQ, resulting in different types of reaction. Hence, our study indicates that multinational firms can learn in different ways from their operations abroad and make new investment decisions based on their accumulated experience and initial performance experiences.

We also investigated the effect of changing ownership and format choices at post-entry on multinational retail firms' survival in those countries. By examining knowledge generated at different places within the firm, this study offers a refined understanding of replication

and adaptation and their effects on performance. Most of the existing studies examined either effects of the search behavior (exploitative vs. explorative) type or the dynamism and complexity of the technological regime on their decisions to leverage within or outside the firm decisions. While most of these studies treat these organizational governance choices as orthogonal, there are also some studies which indicate that firms can be ambidextrous and organize to enable distinctiveness and responsiveness (Gibson & Birkinshaw, 2004) within the same firm (Levinthal & March 1993; March, 1991). Different from these previous studies, we examine organizing for ambidexterity in moderately dynamic contexts and we also extend the discussions on the effect of standardization and adaptation enhancing decisions on MNE performance.

There are several limitations to our study. First, our current data-set tracks the internationalization processes of Walmart and Carrefour only. These two multinational retail giants might have particular strategies regarding the post-entry changes. Future studies can extend our analysis by incorporating smaller firms in to the sample. The post-entry dynamics is a complex phenomenon (Benito et al, 2009), and in this study we focused only on the experience related drivers of post-entry changes. Future research can investigate this phenomenon from Transaction Cost Economics or agency perspectives to develop literature's understanding of the post-entry dynamics. Furthermore, we don't directly measure HQ's assessment of accumulated experiences and initial performance signals coming from the subsidiary location as Tong, Reuer, Tyler, & Zhang (2015) do in their study of Chinese executives' assessments of governance choices but rather assume they receive and act on these information. Following studies can investigate how HQs

receive and act on signals coming from these different types of experiences at host countries.

Nevertheless, our empirical approach was pioneering in terms of tracking MNE's commitment behavior at host countries after their entry, and dividing host country experience into continuous and discrete parts and looking at its effects on ownership and format changes.

CHAPTER 3

DIFFERENTIAL EFFECTS OF LOCAL, FOREIGN FIRMS AND SUPRA-NATIONAL INSTITUTIONS ON THE PACE OF INSTITUTIONAL CHANGE IN DEVELOPING COUNTRIES

ABSTRACT

We investigate the variation in developing countries' rate of compliance with global intellectual property standards. Using old and new institutionalism perspectives, we present a co-evolutionary process of institutional change in innovation systems of these countries, where local firms, advanced country multinational enterprises (AMNEs) and supra-national institutions had differential effects on the institutional change process, in terms of their rate of increasing their intellectual property protection to the level of the developed countries. We track 60 developing countries (from 1995 to the last date of full compliance in 2005) that became part of the Trade Related Intellectual Property Standards (TRIPS) agreement and find that the pressure of foreign firms in developing countries results in faster TRIPS compliance. This relationship is positively moderated by the existence of their on-going dependency to the supra-national institutions such as the International Monetary Fund (IMF). On the other hand, if domestic firms are dominant in the innovation system, it will result in slower compliance to TRIPS, regardless the impact of supra-national institutions on this relationship.

Key words: Emerging markets, Intellectual property protection, innovation capabilities, institutional theory, co-evolution, institutional entrepreneurship

3.1 Introduction

The rise of developing countries is undeniably evident on the global business arena, which is particularly reflected in the increasing evidence of innovative and highly intellectual business activities from these countries. These innovations require searching for and utilizing mostly tacit knowledge (Asheim & Coenen, 2005) and as a result, appropriation from innovations is often prone to asymmetric information problems which constrain owners of innovations from disclosing the tacit knowledge they possess, which in turn can result in failures in the market for ideas (Arrow, 1962; Teece, 1996). On the other hand, it has been well-established that the amount of patent protection is very influential in firms' decisions regarding the nature and location of innovative activities, in addition to their capability endowments and cost calculations (Buckley & Casson, 1976; Cantwell & Mudambi, 2005; Ceccagnoli & Rothaermel; 2008; Coriat & Orsenigo, 2011, Dunning, 1988; Teece, 2006). As a result, governments are in continuous search for optimal level of intellectual property protection standards to ensure there is a conducive environment for the advancement of the local innovation systems (Chaminade, Intarakumnerdb, & Sapprasertc, 2012; Griliches, 1990; Jaffe et al. 1993).

While IP protection standards long have been enforced by established laws and regulations in developed countries developing countries transitioned to higher IP standards only after they became signatories to the Trade Related Intellectual Property Standards (TRIPS from now on) agreement in 1995 enforced by the World Trade Organization (WTO) (Li, 2008; Waguespack, Birnir, & Schroder, 2005). The TRIPS

agreement, set a minimum level of rules and regulations for product patent protection, so that IP protection levels of developing countries would converge to higher IP protection level of the developed countries.

Various prior studies considered TRIPS compliance as a natural experiment (Qian, 2007), however, since developing countries were given special flexibilities it was much more complex process where countries ended up making different policy decisions. The first of such flexibilities was providing developing countries a 10-year grace period to transition to a more rigorous IP regime (Kale, 2010; Li, 2008). Under this flexibility the developing countries were given the flexibility to decide on when to ratify the TRIPS agreement in their national assemblies. The ratification time is important as the provisions and enforcement introduced with the TRIPS could come into the force in these countries only after the ratification took place (Hamdan-Livramento, 2009). Interestingly, while some of the countries ratified the TRIPS agreement right away, some waited until the end of this 10-year period. Secondly, developing countries were given the flexibility to propose and introduce amendments to the original TRIPS patent text during the enforcement of the patent protection laws in their domestic legal system (Li, 2008). Again, similar to the 10-year flexibility case, while some of the developing countries did not make any amendments at all, some of them introduced these amendments. TRIPS were minimum standards, and members were free to provide more extensive protection of IP if they wished (Yang & Sonmez, 2013). Hence, there was still important variation among the developing countries in terms of their rate of full

compliance with the TRIPS agreement provisions (Keupp, Beckenbauer, & Gassman, 2010).

The existence of such variation among developing countries and their rate of compliance to TRIPS agreement suggest that it was indeed an endogenous process (Hamdan-Livramento, 2008; Li, 2008, Ramamurti, 2005; Yang & Sonmez, 2013) and that international agreements such as the TRIPS still have jurisdiction limitations as signatory countries have distinctive national interests and transaction costs (Hathaway, 2008; Scholte, 2001; Weismann, 2010). We are interested in these differences and why different developing countries adapted fast or slow change processes to IP protection standards.

We build our argument on both the new and old institutionalism which suggest that government policies are decided collectively through political strategies, actions, lobbying and connectedness of the political actors inside and outside of a country (Boddewyn & Brewer, 1994; Dolowitz & Marsh, 1996, 2002; Faccio, 2006; Suchman, 1995; Bonardi, Hillman & Keim, 2005). We are particularly interested in the changes of institutions (North, 1990). We consider changes in IP regimes enforced by the TRIPS agreement as an institutional change and investigate the variations in developing countries' TRIPS compliance processes through the lens of co-evolution of institutions. Our main argument is that different innovation actors such as domestic firms or MNEs, also in relation to external pressures inflicted by institutions such as the IMF, had different effects on the local policy decisions of developing countries, which resulted in the varying TRIPS implementation choices by the local governments.

Our inquiry is timely as, recent studies showed that both country-specific factors (Ginarte & Park, 1997; Papageorgiadis, Cross & Alexiou, 2014; Park, 2008), and external factors (Jandhyala, 2014) are influential in countries' in the divergence of patent protection but they still lack the investigation of political economy dimensions and the motives of domestic vs non-domestic interest groups in the TRIPS decision making process. (Landes & Posner, 2003; Park, 2008; Yang & Sonmez, 2013). Moreover, we respond to a call in the institutionalism field (Dacin, Goodstein & Scott, 2002), requesting further insights on the aspect of pace and time in institutional change processes

Explaining the compliance period requires us to tease out those developing countries' TRIPS decision processes by simultaneously assessing the relationship between endogenous factors and the divergence in IP regime in each country (Hafner, Burton & Tsutsui, 2005; Jandhyala, 2014; Westphal & Zajac, 1995). Hence, we track the evolution of IP protection regime along with developments in the innovation systems, and role of different actors during the developing countries' TRIPS compliance process (Antonelli, 1994; Dhalman & Ross-Larson, & Westphal, 1987; Kumaraswamy, Mudambi, Saranga, & Tripathy, 2012). Our sample consists of the complete population of 60 developing countries that became party to the TRIPS agreement in 1995 and tracks the country level factors from the World Bank Databank and changes in the IP standards starting from 1995. We merge this data with the assignee location within the patent documents derived from USPTO to investigate the different effects of the local

firms vs. MNEs and supranational institutions on local governments' decisions related to the TRIPS implementation.

Our results show that if AMNEs increase their presence in the local innovation system in a developing country in terms of the assignee composition of patents in a given year, such countries are less likely to use the 10-year flexibility or engage in doing amendments to the original TRIPS text. Alternatively, we find that developing countries with increasing compositions of domestic firms as assignees of patents in a given year, they will transition into the full compliance with TRIPS more slowly and they will be more likely to engage in doing amendments to the original TRIPS text. Lastly, we also consider the supra-national institutions, specifically IMF, had an important effect on this process. We argue that, if a developing country was in the process of acquiring a credit from IMF, the lobbying efforts of AMNEs for a faster transition to the TRIPS were positively moderated and the lobbying efforts of local MNEs for a slower transition to the TRIPS was less pronounced.

The paper is organized as follows. After discussing a theoretical framework and developing hypothesis, we outline methods and findings of our data analysis. We conclude the paper with a discussion and conclusion section.

3.2 Background: Institutions and Innovations

Institutions are a cluster of formal and informal rules that shape behaviors and human interaction, including the legal system, regulations, habits and customs (Coriat & Weinsten, 2002; North, 1990; Scott, 2001). We are interested in formal rules that are enforced by governments in form of policies and acknowledge that these formal policies

are not always implemented and followed stringently especially in developing countries. There is often disconnection between legislative and executive implementation of policies, especially in these country contexts.

The institutional theorists suggested that firms compete for institutional fitness in addition to seeking economic efficiency (North, 1990). Therefore, the institutional environment is a main and direct driver of firm strategies, government policies and their performance, rather than only being a background variable (Delios & Henisz, 2003; Peng, 2003; Wright, Filatotchev, Hoskisson, & Peng, 2005). The literature on the institutional view of the firm has looked at fundamental questions such as the effect of institutions on choosing between different governance structures (Filatotchev et al., 2008), diversification strategies (Peng, Lee, & Wang, 2005; Wan, 2005) on entry-modes for MNEs (Delios & Henisz, 2003) and strategic change (Lewin & Kim, 2004). We are particularly interested in studies that are at the intersection of institutions and innovations (See: Mytelka and Smith, 2002; Lundvall and Borrás, 2005).

While, innovations have long been seen as the natural result of progressions in scientific knowledge alone, backed by the institution-based view of organizations, the literature on National Innovation Systems (NIS) (Lundvall, 1992; Edquist, 1997; Nelson, 1993; Freeman, 1987) considers that innovation is, in fact an endogenous process where the actors, policies, incentives, infrastructure and path dependencies all together determine the innovative outcomes (Antonelli, 1994; Ghauri & Rao, 2009; Luo, 2001; Lundvall, 1997; McGaughey, Liesch, & Poulson, 2000; Peng, 2001).

The early research on the institutional view of innovation explored actors that make up the institutional environment of innovations and the nature of the relationships among different institutions (Antonelli, 1994). However, most of these early studies were done on developed countries where the institutional environment is already established, so that they provide a static perspective of institutions. On the other hand, the institutions within developing countries is in transition and flux (Dacin, et al, 2002; Peng et al, 2008) since, the formal institutions such as the intellectual property standards are in the process of emergence (Peng, 2003; Peng et al, 2005).

The potential for institutional volatility in developing country contexts makes the relationship between institutions and organizations become more salient (Makino, Isobe, & Chan, 2004) and paves the way for a more dynamic understanding of institutions. Hence, in this paper we focus on the developing countries to analyze the variation in institutional environments from one country to another and the process of institutional change (Coriat & Weinstein, 2002; Jandhyala, 2014). We build our analysis of the divergence in developing countries' TRIPS compliance rates using the institutional change framework (Demsetz, 1967, 2008; North, 1990, 2005).

3.2.1 Unidirectional Institutional Change

The institutional theory described institutional change as a process that transforms the established norms to operate, or conditions that provides legitimacy to organizations within the institutional environment (North, 1990). Early neo-institutional theory provides us a limited understanding of the institutional change, since these studies consider organizations as passive or black-boxes (Antonelli, 1994) that are entitled to

conform to isomorphic institutional pressures in a deterministic way and accept environmental conditions as given and are only allowed to adjust prices or the quantity (Geels, 2014). This view contends that organizations are operating in a field whose rules are pre-defined, and portrays them as continuously competing with each other for legitimacy to sustain their “license to operate” (DiMaggio & Powell, 1983; Suchman, 1995). On the other hand, governments constitute the formal institutions that determine borders of the legal and regulatory environment (Peng, Wang, & Jiang, 2008) and they are accepted as the sole decision makers who have the complete information about the innovation systems (Nill & Kemp, 2009). Through setting up the “rules of the game” and framing organizations’ innovative activities, governments have a crucial role in designing and facilitating the eco-systems that enable efficient flow and connectivity of technology and information among people, enterprises and universities (Coriat & Weinstein, 2002; Roy & Oliver, 2009; Loasby, 1990; Paraskevopoulou, 2012).

In sum, the with the early institutionalism perspective, the role of non-state agency in the innovation policy is downplayed as if the institutional environment and organizations interact in a unidirectional sense (Coriat & Weinstein, 2002; Faulkner, 2009; Nil & Kemp, 2009). That is, organizations almost don’t play a role during the change of policies/regulations or transformation of the innovation systems (Coriat & Weinstein, 2002; North, 1990).

3.2.2 Co-Evolutionary Nature of Institutional Change

The evolutionary economics literature (Nelson & Winter, 1982), oppose the idea of a single actor, such as the government to have the absolute information that can direct

firms to reach the absolute optimality (Chaminadea, et al, 2012; Metcalfe, 1994). The evolutionary economists inspired by the new institutionalism (see North, 1990; Slembeck, 1997; Paraskevopoulou, 2010) stresses the importance of institutions for economic change (North, 1990; 1995;Williamson, 1985) and present an evolutionary story of the institutional change in answering questions related to how institutional environments form and transform (Nelson & Nelson, 2002; Waguespack, Bimir, & Schroeder, 2005).

The evolutionary innovation - institution perspective suggest that the government intervention is dependent on the health of innovation system and it takes place to solve the systemic problems affecting the innovation (Edquist, 1997; Lundvall, 1992). These studies show that governments often have limited and imperfect information (Corriat & Weinstein, 2002), and lag behind the understanding of innovation (Paraskevopoulou, 2012) resulting in a trial and error approach until better policy options are found. Thus, the change of the institutional environment is affecting innovations and need to be studied as a process rather than as a static activity (Metcalfe & Georghiou, 1998; Metcalfe, 1995).

Existing literature has associated institutional change within countries with variations in either internal factors such as the development level (Ginarte & Park, 1995; Park, 2008), income level (Weiss & Jacobson, 1998; Marron & Steel, 2000), type of government (Hathaway, 2002; Li & Resnick, 2003) or to ones that are external such as trade activity and being a member of WTO (Yang & Sonmez, 2015). However as

Waguespack et al. (2005), point out, we have still a limited understanding of how a country's institutions come to be what they are and the endogenous selection forces.

Recently, the studies in institutional perspective started to consider the relationship between the changes in government policies, rules and regulations and institutional environment as endogenous and more complex (Parakevopolou, 2012; Patriotta, Gond, & Schultz, 2011; Thornton, Ocasio, & Lounsbury, 2012) rather than describing it as a result of natural evolution and blind process where only the exogenous macro-historical context is at work (Lawrance & Philips, 2004). This view is described as institutional entrepreneurship (Kostova, Roth, & Dacin, 2008) and different than the prior studies, scholars with such perspective on institutional change claim that the interests, incentives, and power dynamics of different actors within the institutional environment shape institutions (Greenwood & Suddaby, 2006; Hirsch & Lounsbury, 1997; Jandhyala, 2014; Scott, 2008). That means, the relationship between regulation and organizational innovation should no longer considered as unidirectional and static, but rather a bi-directional and dynamic (Fiori, 2002).

Such innovation –first/regulation-after approaches were evident in recent studies such as in Lounsbury (2007)'s work on the evolution of the US mutual funds industry, Metcalfe and James' (2005) study on regulative changes in the medical industry and Kemp and Loorbach's (2007) study which presents a multi-stakeholder perspective during the transitioning of innovation policies in the Dutch energy industry and Liua, Simonb, Suna and Caoc's (2011) analysis of evolution of the innovation policies at China. All of these studies share the common conception that governments, firms and

other stakeholders, aka actors in the institutional environment, are required to be in continuous coordination (Faulkner, 2009) and only with working variation, retention and selection mechanisms optimal design of the innovation system is reached (Nelson & Winter, 2009; Waguespack et al, 2005).

Similarly, the research in both management and economics fields have explored how firms can improve their performance by shaping the institutional context (Feinberg, Hill, & Darendeli, 2015). They can proactively affect governments' decisions through political strategies, actions, lobbying and connections (Alon, Gurumoorthy, Mitchell, & Steen, 2006; Boddewyn & Brewer, 1994; Eden & Lenway, 2001; Faccio, 2006; Suchman, 1995; Bonardi, Hillman & Keim, 2005; Oliver & Holzinger, 2008). Moreover, Oliver (1992) identified that aforementioned political pressures resulting from different interests and power dynamics within the institutional are an important factor affecting institutional change connecting these arguments back to earlier institutional change discussions.

The existence of the multilateral interaction within the institutional environment suggest that as organizations change so do institutions, and there is a co-evolutionary process on going within the transformation of institutions within the innovation systems (Lundan, 2011; Nill & Kemp, 2009; Smits & Kuhlmann, 2004). During this process, first, organizations seek to influence the direction of the institutional change towards their motives and incentives, and in-turn the newly emerged institutional environment changes other organizations. Hence, different actors within the innovation systems including firms, regulations and "regulation setters" co-evolve with each other

(Faulkner, 2009). We investigate the TRIPS compliance process from the co-evolutionary perspective.

3.3 Theory: TRIPS and Different Co-evolutionary Trajectories of Developing Countries

“Co-evolution does not mean that everything is coevolving with everything else, but rather requires the identification of what is co-evolving with what...” (Malerba, 2006: p. 18)” Different selection processes in different institutional environments takes place at the same time and this affects the co-evolution to take different trajectories, which then leads to institutions changing at different paces among different contexts (Carney & Gedajlovic, 2002; Liua et al, 2011). We follow Cantwell, Dunning and Lundan (2010)’s view to tease out factors affecting the differences in the institutional co-evolution trajectories. These authors maintain the idea that that the level and complexity of interaction of different actors within the institutional environment is central in deciding the trajectory of the institutional change.

Different than these prior studies we investigate differential effect of actors on the rate of institutional change, based on the idea that during an institutional change process, multiple institutional logics exist and compete for attention at different point of times (Dacin et al., 2002). Bebchuk and Neeman (2010) investigate how different interest groups in a society influence the level of investor protection by the government. Similarly Geels (2014), distinguishes organizations into three types according to the power to discipline others and shape regime or rules to suit their interests, and presents a “triple-embedded framework” of institutional co-evolution.

Varying trajectories of institutional change and roles of different actors in this process can be particularly observed in the divergence in developing countries' rate of compliance to TRIPS agreement and using flexibilities (Yang & Sonmez, 2012). While some of these flexibilities were related to global or local epidemics such as HIV/AIDs, avian flu or leukemia for the least developed countries (Jandhyala, 2014), we are interested in the flexibilities that are particularly related to the level of enforcement of the TRIPS. The governments of developing countries were trying to decide on optimal compliance pace with the provisions that TRIPS were asking, given the opportunities for flexibilities and amendments to the original text (Li, 2008). They ended up handling this transition period to ratify TRIPS in various ways. For example, India incrementally changed domestic IP standards and capitalized on the full transition period, while Brazil and Turkey implemented the required IP regulations immediately without any transition period. Moreover, some countries introduced amendments to the original TRIPS text (Hamdan-Livramento, 2009).

While the evolutionary institutional change is continuous and incremental it also occurs at different paces. Change processes are by nature connected with the concept of time and can reflect fast or slow change evolution. While the literature just started to consider the organizations' activism during different times of the regulatory/policy life-cycle (Bonardi & Keim, 2005; Coriat & Weinstein, 2002; Waguespack et al, 2005), the time aspect of the institutional change in terms of rate/pace of the change has not been studied much in the literature (Dacin et al, 2002). Most importantly for this study and

where we aim to contribute to this literature stream is the consideration of pace of institutional change.

We consider the variation in developing countries compliance to the TRIPS agreement as an example to institutional change happening at different paces and identify different actors within the innovation systems of developing countries that had an effect on this pace. Recent policy studies use the term ‘policy network’ to describe the set of national and international actors and institutions that shape policies (Howlett & Ramesh, 2003). Therefore, we consider domestic firms vs. MNEs that engage in innovations within the innovation system of the developing countries as the central actors that can use power to shape institutions to their advantage. (Faulkner, 2009; Greenwood & Suddaby, 2006). We compare and contrast the roles of these actors that had opposing stakes in the TRIPS decision process. Then, driven by the arguments from the neo institutionalism, we introduce supranational organizations within the set of actors affecting the co-evolution of developing countries’ intellectual property regimes. We provide a framework that outlines such interactions between different actors and different paces of institutional change (Figure 3.1).

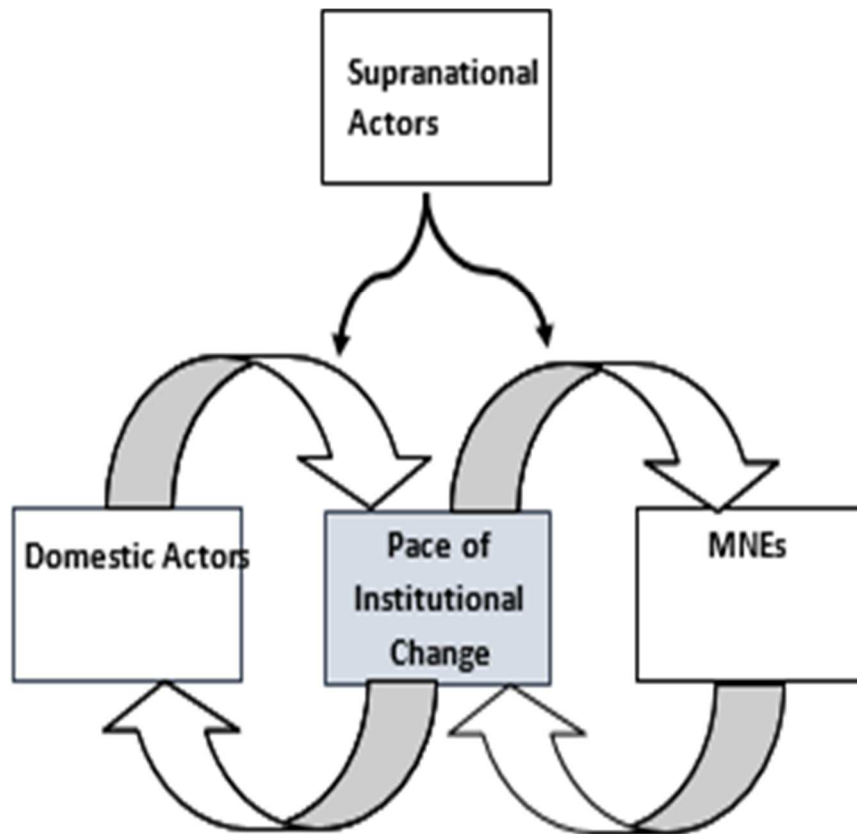


Figure 3.1 Co-evolutionary Relationship between different actors within the Innovation System and pace of Institutional Change

3.3.1 Increasing Presence of Domestic Owners in Innovation Systems and Rate of TRIPS Compliance

The different incentives of players result in changes in institutions at the margin and in different paces (North, 1990). Among the three major players of interest groups that we have identified within the innovation systems, the domestic firms are considered as the primary and endogenous force for the co-evolution (Hafner-Burton & Tsutsui, 2005; Krug & Hendrichske, 2007; Pistor, 2002). These firms serve the interests of the domestic development, and inform, train and engage in bargaining with their government to have an influence on the decisions regarding changes in policies, laws and regulations (Faccio, 2006; Fisman, 2001, Hillman & Hitt, 1999).

In the case of intellectual property protection, the incentives of domestic firms are different than the MNEs. In a developing country, and especially in the early stages of catch up, most of the domestic firms will possess process capabilities rather than innovative capabilities (Kumaraswamy et al, 2012). Similarly, Brandl et al 2014 showed that, in the case of India, the innovation network of India was dominated by the foreign firms in its conception, and it required a certain amount of time for the domestic firms to claim their positions as innovators within the Indian innovation system. Moreover, Antonelli (1994) shows that the more localized the technological change is, the switching costs for firms to adhere to a common standard will be larger. In the case of TRIPS compliance, domestic firms will perceive higher transaction costs to switch to a higher IP protection immediately (Ramamurti, 2005).

From a government's perspective, providing lower IP protection standards can help domestic firms to learn to source knowledge and form collaborations during the transition and consolidation phases, often through imitation and knowledge spillovers (Kumaraswamy et. al, 2012). Domestic firms can then develop necessary absorptive capacities to move to the often referred to as 'second phase' of development in the catch-up based on imitation activities (Awate et. al, 2012). For example, industries such as healthcare and electronics are often of vast importance to developing country governments (Abrol, 2004; Chin & Grossman, 1990; Deardorff, 1992; Li, 2008). The local governments might be aware that existing innovative capabilities of domestic firms are not mature enough to compete with multinational firms (Li, 2008) and they would want to achieve at least some level of protection for the domestic firms in such industries (Bevan, Estrin, & Meyer, 2004; Rugman & Verbeke, 2001).

Given the common threat of increasing patent protection level and preventing imitation, domestic firms can then collectively act with the objective to influence governments' TRIPS decisions in order to get them designed and implemented in their own interest (Edquist, 2001; Geels, 2014). The existing literature on lobbying shows firms have important influence on the policy life-cycle (Bonardi, Hillman & Keim, 2005). Similarly, literature on institutional entrepreneurship suggests that firms can engage in manipulation strategies to shape the institutional environments surrounding them (Garud et al., 2007; Greenwood & Hinings, 1996; Oliver, 1991). Once domestic firms gather enough influence they can slow down the adoption of higher quality standards (Acemoglu et al., 2005; Acemoglu & Robinson. 2001). Accordingly, we argue that,

increasing presence of domestic firms in an innovation systems in developing countries will result the usage of a 10-year flexibility period and/or introduced amendments to original IP regulations, resulting in a slow transition to full TRIPS compliance:

***H1:** A slower transition to full TRIPS compliance, will more likely occur in cases with a higher composition of local firms within innovation systems of developing countries.*

3.3.2 Increasing Presence of Advanced Country MNEs within Innovation Systems and Rate of TRIPS Compliance

On the other hand, there are a number of studies which show that the decision to ratify TRIPS immediately or capitalize on the 10-year transition period instead, was not solely the result of domestic actors' actions within the developing countries' innovation systems (Coriat & Orsenigo, 2005). MNEs are often active in the law making processes in the developing countries that are characterized by institutional voids in the IP standards (Khanna, Palepu, & Sinha, 2005). Since lower levels of IP protection in the developing countries would hinder firms engaging in doing competence-creating activities in such locations, multinational firms are often very protective of their IP so that they will want to make sure that their specific assets are protected (Cantwell & Mudambi, 2005; Ceccagnoli & Rothaermel; 2008; Coriat & Orsenigo, 2011; Teece, 1986). Hence, such contexts offers MNEs reasons to engage in institutional entrepreneurship (Cantwell, Dunning, & Lundan, 2010). MNEs can develop deep personal and organizational connections with leading governmental figures and entities

(Cuervo-Cazurra, 2006; Faccio, 2006; Sun, Mellahi, & Thun, 2010) and engage in relational political behavior in the developing countries to shape their institutional change decisions (Boddeyn & Brewer, 1994; Hillman & Hitt, 1999).

MNEs demand a higher appropriability regime at those developing countries in which they have been already present within the local innovation systems, so they can lobby governments for transitioning to higher standards (Jandhyala, 2014). As a result of increasing pressures from the MNEs, the developing country governments can give in and raise the IP standards to attract R&D seeking MNEs (Dunning & Lundan, 2008) with the hope that higher IP protection leads to learning and spillover externalities to local firms and initiates the evolutionary process of output/imitative capabilities development (Breschi & Malerba, 2001; Kumaraswamy et al. 2012). For example, in the case of the pharmaceutical industry, MNEs and governments from mature market economies extensively lobbied towards a fast ratification of TRIPS during the TRIPS talks (Kale, 2008; Ramamurti, 2005). Consequently, various developing country governments decided to ratify the TRIPS agreement in their national assembly's quickly or did not introduce amendments (Li, 2008; Qian, 2007). Hence, we argue that the rate of developing countries' compliance to TRIPS is influenced by pressures of multinational firms (Tödtling, & Trippel, 2005). Accordingly, we hypothesize:

***H2:** A faster transition to full TRIPS compliance, will more likely occur in cases with a higher composition of AMNEs within innovation systems of developing countries.*

3.3.3 Indirect Effect of Developing Country IMF Dependence on the Relationship between Different Composition of Different Owners of Innovation within Innovation Systems and Rate of TRIPS Compliance

The change in institutional environment in developing countries' innovation systems is also affected by the countries relationship with organizations other than domestic and non-domestic firms (Jandhyala, 2014). The studies of neo-institutional perspectives suggest that supranational institutions such as the WTO, OECD and the IMF can also apply external pressures that influence policy decisions of developing country governments (Biermann, 2002; Dolowitz & Marsh, 1996, 2002; Henisz et al, 2005; Hill, 2013; Jandhyala, 2015; Roelandt & Hertog, 1999). However, these pressures are often subtler and less explicit than the direct effects of domestic firms and MNEs (Lemola, 2002). Instead they might provide indirect support for the co-evolution by creating the necessary institutional space where micro-level actors such as MNEs engage in negotiating and bargaining (Krug & Hendrischke, 2007).

We focus on the effect of IMF on the institutional change in developing countries, as they are seen as organizations which often intervene with the sovereignty of the developing countries and support the agenda of developed countries (Hill, 2015). Prior research reported the significant effect of IMF on the process of India's tariff law decisions. The IMF required India to lower its import tariffs (Bown & Tovar, 2011; Feinberg, Magelssen & Smith, 2014; Topalova, 2008) and as a result the Indian government implemented reforms rapidly. Similarly, in the case of compliance with TRIPS, if the developing country is seeking a credit from the IMF, the IMF in turn

might intervene in the process, taking the MNEs' side for pressuring local governments for a faster transition (Ramamurti, 2005). Hence, we argue that the dependency on supranational institutions, which includes IMF credits, influence TRIPS compliance process and will moderate the relationship between the composition of domestic vs non-domestic firms in a national system and governments' decisions affecting compliance with the TRIPS. We suggest that developing countries' dependence to IMF will positively affect the MNEs' existing pressures for a fast transition to TRIPS since IMF will indirectly support MNEs lobbying efforts for a faster transition while such dependency will curtail the domestic firms' lobbying efforts towards slower transition.

***H3a:** The dependency of a developing country to the IMF will negatively moderate the relationship between the composition of local firms and rate of compliance to TRIPS*

***H3b:** The dependency of a developing country to the IMF will positively moderate the relationship between the composition of AMNEs and rate of compliance to TRIPS*

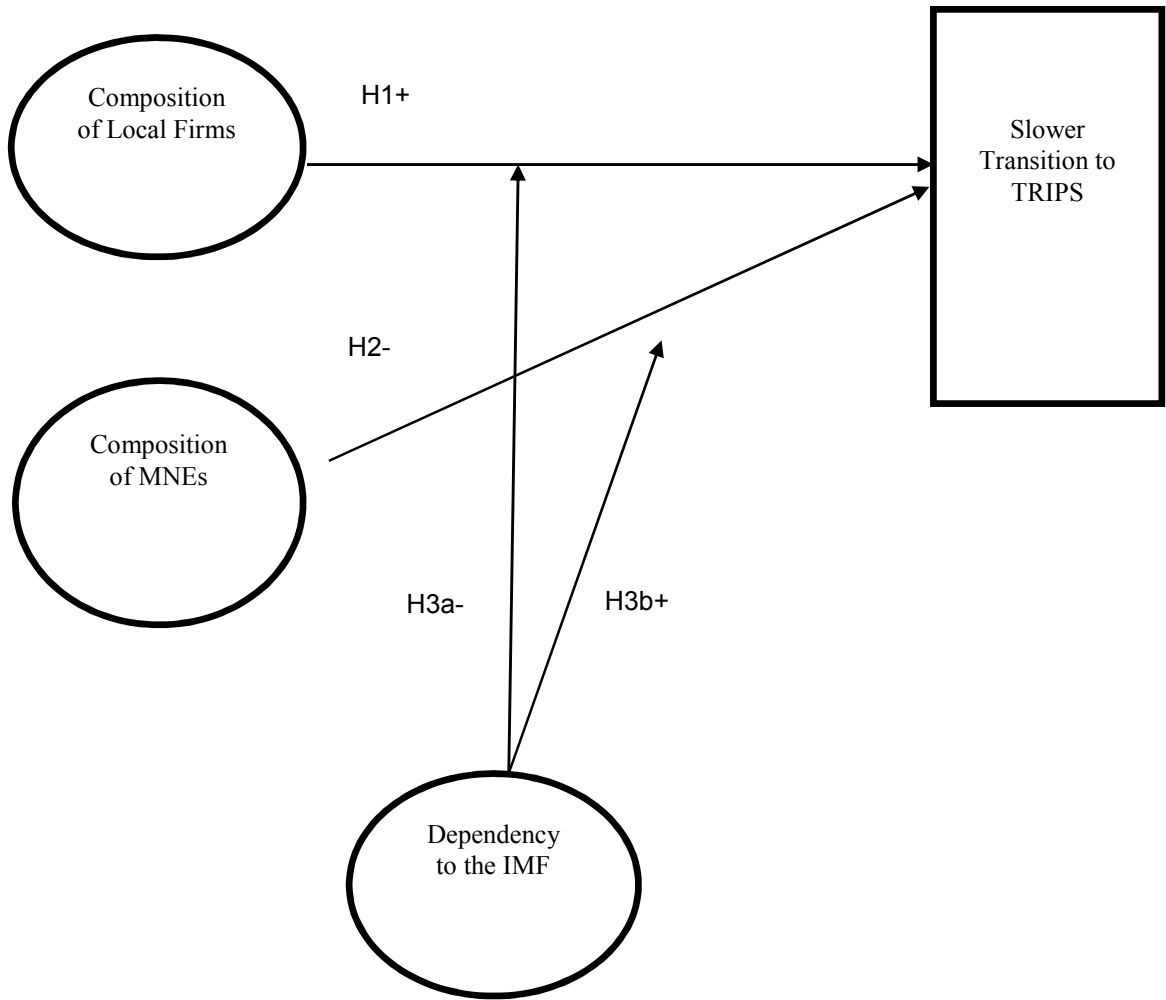


Figure 3.2. Model of Local vs. AMNE Compositions within Innovation Systems and Indirect Effect of Supranational Institutions on Rate of TRIPS Compliance

3.4 Methods

3.4.1 Data and Sample

We track changes in IP regulations of the 60 developing countries that became party to the TRIPS agreement in 1995. We use the compliance evaluation documents submitted by each of the developing countries in the WTO's website to identify the changes and events in the IP regulations in the post TRIPS period. Our data set covers all IP policy decision history of the 60 developing countries, indicating whether they had used the 10-year flexibility or not, whether they had initiated any amendments to the original TRIPS text or neither. We track the development of innovation systems of the developing countries for their IP intensive industries (Delgado, Kyle & McGahan, 2013) such as pharmaceutical, electronics, and computer and software industries in the developing countries. We merged this data with the assignee location data listed on the patent documents from the Harvard Patent Data Verse by manually parsing out the assignee compositions per year – per country and coding this unique information. As a last step, we included the country level development indicators from the World Bank DataBank. We collapsed all of the variables at country level and final sample consists of 780 country-year observations.

3.4.2 Measures

Dependent Variable: TRIPS Decisions:

We constructed our own TRIPS compliance index, coding developing countries' IP related regulatory decisions after 1995 until 2005 since only alternative available

TRIPS index is by Hamdan-Livramento (2008), but it does not cover all the developing countries in our data-set. Our final measure is an ordinal variable, which ranks developing countries' TRIPS related decisions from 1 to 4. A number 1 indicates when a developing country has not used the 10-year flexibility or has passed any local firms indicating some sort of amendments to the original TRIPS text. Thus, the IP standards in the focal developing country are very high and closest to the level of a developed country. A number 2 indicates if the focal country has only used the 10-year flexibility. A number 3 indicates if the focal country amended its regulations but has not used the 10-year flexibility period. Finally, a number 4 indicates if the focal country both used the 10-year flexibility and amendments, so that IP standards are furthest away from that proscribed by the TRIPS agreement. In other words, a number 1 indicates a fast transition to TRIPS while number 4 indicates a slower transition to comply with TRIPS regulations (Table 3.1). We cross-checked out coding with Hamdan-Livramento TRIPS index for the available countries.

TABLE 3.1: Indicators and TRIPS Decisions

TRIPS Decision/Slowness of the Institutional Change	Indicators	Sources
1	<p>The country did not use any flexibility</p> <p>The country ratified the TRIPS agreement in national assembly in 3 years from the time they became party to the international agreement</p> <p>The enforcement mechanisms are in full jurisdiction.</p>	<p>WTO Texts</p> <p>Hamdan-Livramento, 2008</p>
2	<p>The country used the 10-year flexibility only</p> <p>TRIPS agreement in national assembly after 3 years from the time they became party to the international agreement.</p> <p>The enforcement mechanisms are not in jurisdiction.</p>	<p>WTO Texts</p> <p>Hamdan-Livramento, 2008</p>
3	<p>The country has introduced amendments to the TRIPS original text</p> <p>The country ratified the TRIPS agreement in national assembly in 3 years from the time they became party to the international agreement</p> <p>The enforcement mechanisms are not in jurisdiction.</p>	<p>WTO Texts</p> <p>Hamdan-Livramento, 2008</p>
4	<p>The country used the 10-year flexibility</p> <p>TRIPS agreement in national assembly after 3 years from the time they became party to the international agreement.</p> <p>The enforcement mechanisms are not in jurisdiction.</p>	<p>WTO Texts</p> <p>Hamdan-Livramento, 2008</p>

Independent Variables

Assignee Compositions: We manually parsed the assignee information listed in each patent document to identify if a patent under our focus was owned by a local firm, an MNE, a local institution, a foreign institution or an individual (Li, Lai, D'Amour, Doolin, Sun, Torvik, Zu, & Fleming, 2014). Our final measure is a count measure of composition of local firms and MNEs that were listed as assignees in the patent documents at the patent application year, per country. We normalized and transformed these measures into percentage measures by dividing it by total number of assignees.

Assignee Compositions * Dependence to the IMF: We measure the main effect of Dependence to the IMF by looking at whether the focal developing country had used IMF Credit before, in World Bank's Databank. We identify if the focal developing country had an on-going stand-by or credit agreement with the IMF and determine the amount of current IMF credit used by the developing country. We then multiply local firm vs AMNE compositions with the IMF Dependence for the interaction variables.

Control Variables

Patents as innovation capabilities

IP policy decisions are statistically related to the innovative capabilities of countries (Qian, 2007). Therefore we measure local innovation capabilities through the use of patents. Innovation and technology management research has used patents as reflection of innovation capabilities of firms for many years (Griliches, 1998; Jaffe, Trajtenberg & Henderson, 1993; Narin, Norma & Perry, 1987). We follow with this

line of research and consider a firm's patent output as its main identification factor for innovation capabilities (Awate et al, 2012; Jaffe et al., 1993).

However, we also acknowledge that using patents to identify the innovation capabilities of a country raises issues concerning the economic value of patents (Hall, Jaffe, & Trajtenberg, 2001; Pakes & Griliches, 1998). Patent count might not be an extensive measure of innovation and R&D development (Acs, Anselin & Varga, 2002). Therefore, we regress other innovation capability related factors such as the number of scientific journal articles published by authors from the focal country, the average number of subclasses, eigenvector centrality of the patents from the focal developing country, the number of total inventors on patents. Then, employing a two-step estimation, we use these estimates as instruments for measuring local innovation capabilities in the main regression.

The patent specific data are mined from the United States Patent and Trademark Office (USPTO) by classifying patents that are representative of the pharmaceutical, electronics, computer and software industries by using the Hall, Jaffe, & Trajtenberg (2001) classification. We used these 4 industries as representatives of knowledge-intensive industries that are directly affected by IP related regulations (Delgado, Kyle, & Mc Gahan, 2013). The patents extracted were patents applied for between January 1, 1993 and December 31, 2005, in line with TRIPS time-frames.

Other Controls: We also use a number of other controls at the country level such as GDP per capita, health expenditures by government, indices for export value, domestic credit to private sector, control of corruption, political stability and absence

of violence, voice and accountability, regulatory quality, government effectiveness, rule of law and measures for local vs. foreign institution compositions within the local innovation systems. Since changes in technologies, countries and other external exogenous factors can affect both the innovative capabilities, assignee compositions and TRIPS compliance decisions, we include year fixed effects to our patent estimation and TRIPS models as well.

3.4.2 Estimation:

We use a 2-step instrumental variable estimation to account for possible endogeneity problems related to the developing countries' TRIPS related policy decisions (Qian, 2007). Innovative capabilities of countries are spuriously related to assignee compositions and TRIPS compliance decisions at developing countries. Therefore, first we regressed the innovation capability related variables at the country level to number of patents per year and then used these estimates as instruments in our main regression variable to control for local innovation capabilities. In the second stage, we use ordered-probit estimation through "conditional mixed process" (cmp) estimator with multilevel mixed random effects module in STATA 12. This estimation controls for the endogeneity with the instruments and allows testing the model with ordered ordinal outcomes with instruments (Roodman, 2011). For normality concerns we performed log transformations on certain variables, we also ran a multicollinearity test and confirmed that VIF levels are below 10.

3.4.3 Results

The Table 3.2 presents the descriptive statistics. As our sample shows, firms USPTO patenting activity varies a low, as well as the composition of different assignees and TRIPS decisions. Overall, institutional environment variables have high and significant correlations among them. Interestingly, GDP per capita and #of patents variables don't have high correlation, as well as the #of patents and TRIPS decisions variables. Table3-3 shows the results for the first stage regression results for estimating the local innovation capabilities. All of the variables except geographical dispersion of patents are significant.

TABLE 3.2: Descriptive Statistics

Variable	Obs	Mean	Std. Dev.	Min	Max
TRIPS Decisions	780	1.769231	0.976266	0	4
Comp of Local Firms	557	0.123567	0.188141	0	0.916667
Comp of AMNEs	557	0.536493	0.32322	0	1.083333
Use of IMF Credit	557	1.80E+08	7.61E+08	0	9.29E+09
# of Patents	780	239.0692	1286.162	0	18368
GDP per Capita	763	7.97421	1.578374	0.472431	47081.2
Health Expenditures	605	2.24304	0.491484	1.163488	4.368789
Export Value Index	767	401.8217	2330.194	27.9743	25189.8
Domestic Credit	748	115.4813	1135.483	-79.0924	23348
FDI Inflow	705	1.25444	3.515402	-16.5889	8.61E+08
Political Stability	600	44.92067	25.17338	0.961538	99.51923
Rule of Law	600	50.1551	23.22099	0.956938	95.69378
Government Effectiveness	599	56.04422	21.03451	7.317073	100

TABLE 3.3 Number of Patents as Instrument for Innovative Capability

	(1) # of Patents
Scientific and Technical Journal Articles	0.0000416*** (5.81)
GDP Per Capita	0.777*** (6.04)
Geographical Dispersion of Patents	-0.137 (-0.91)
Total # of Inventors	0.0000370*** (4.27)
Number of Subclasses	-0.00000570* (-2.37)
Year Fixed Effects	Yes
_cons	-1.934 (-1.79)
<i>N</i>	313

t statistics in parentheses

* $p < 0.05$, ** $p < 0.01$, *** $p < 0.001$

Table 3.3 tests the hypothesized relationships. Model 1 tests H1. The results indicate a positive and significant effect of composition of local firms on the likelihood of slower transition to the TRIPS. Model 2 tests H2. The results indicate that there is a negative and significant effect of MNE composition on the likelihood of a slower transition to the TRIPS. Models 4 and 5 test H3a and H3b. As Model 4 shows, we failed to find support for the negative moderation of the local firm composition by the dependency to the IMF as we had hypothesized in H3a. As the model 5 suggests, the coefficient for AMNE composition * IMF dependency interaction term is negative and significant indicating that there is a statistically significant negative moderation of IMF dependence on the effect of MNE composition on TRIPS decision, supporting the H3b.

TABLE 3.4 Direct Effects of Local Firm Composition vs. AMNE Composition & Indirect Effect of Dependency to IMF on TRIPS Compliance

	(1) Slower Compliance	(2) Slower Compliance	(3) Slower Compliance	(4) Slower Compliance
Composition of Local Firms	2.008*** (3.78)		1.323 (1.55)	1.363* (2.31)
Composition of AMNEs		-1.144*** (-4.82)	-0.933*** (-3.80)	-0.833*** (-3.39)
Use of IMF credit			-1.01e-10* (-2.28)	1.80e-10 (1.72)
Local Firms * Use of IMF			3.11e-10 (1.83)	
AMNEs * Use of IMF				-4.18e-10* (-2.03)
# of patents	-0.000269*** (-3.69)	-0.000192*** (-3.55)	-0.000310 (-1.49)	-0.000306*** (-3.84)
GDP per capita	-0.269*** (-3.36)	-0.263*** (-3.32)	-0.288*** (-5.36)	-0.292*** (-5.44)
Export Value Index	0.00257 (0.84)	0.00192 (0.63)	0.00271 (1.09)	0.00264 (1.08)
Domestic Credit	-0.00216 (-1.31)	-0.00225 (-1.35)	-0.00270 (-1.59)	-0.00263 (-1.59)
FDI inflow	-0.0994*** (-4.32)	-0.0933*** (-4.13)	-0.104*** (-4.42)	-0.104*** (-4.56)
Political Stability	-0.00420 (-1.03)	-0.00738 (-1.81)	-0.00860 (-1.68)	-0.00873* (-2.04)
Rule of Law	0.0290*** (4.03)	0.0393*** (5.08)	0.0396*** (4.53)	0.0389*** (4.96)
Government Effectiveness	-0.0108 (-1.49)	-0.0133 (-1.82)	-0.0134 (-1.78)	-0.0125 (-1.66)
Local Inst	0.206 (0.57)	0.0446 (0.12)	0.0264 (0.07)	0.0163 (0.04)
Foreign Inst	-0.000365 (-0.00)	-0.562* (-2.15)	-0.393 (-1.48)	-0.371 (-1.39)
Year Fixed Effects	Yes	Yes	Yes	Yes
<i>N</i>	362	362	362	362

t statistics in parentheses

* $p < 0.05$, ** $p < 0.01$, *** $p < 0.001$

The interaction between AMNE composition and IMF dependency is more visible in Figures 3.3. As Figure 3 indicates, the slope of the relationship between the composition of AMNEs and the slower compliance to TRIPS is negative. As the dotted lines indicate, at higher levels of this dependence, the slope of this line becomes more negative, which visualizes the negative moderation relationship.

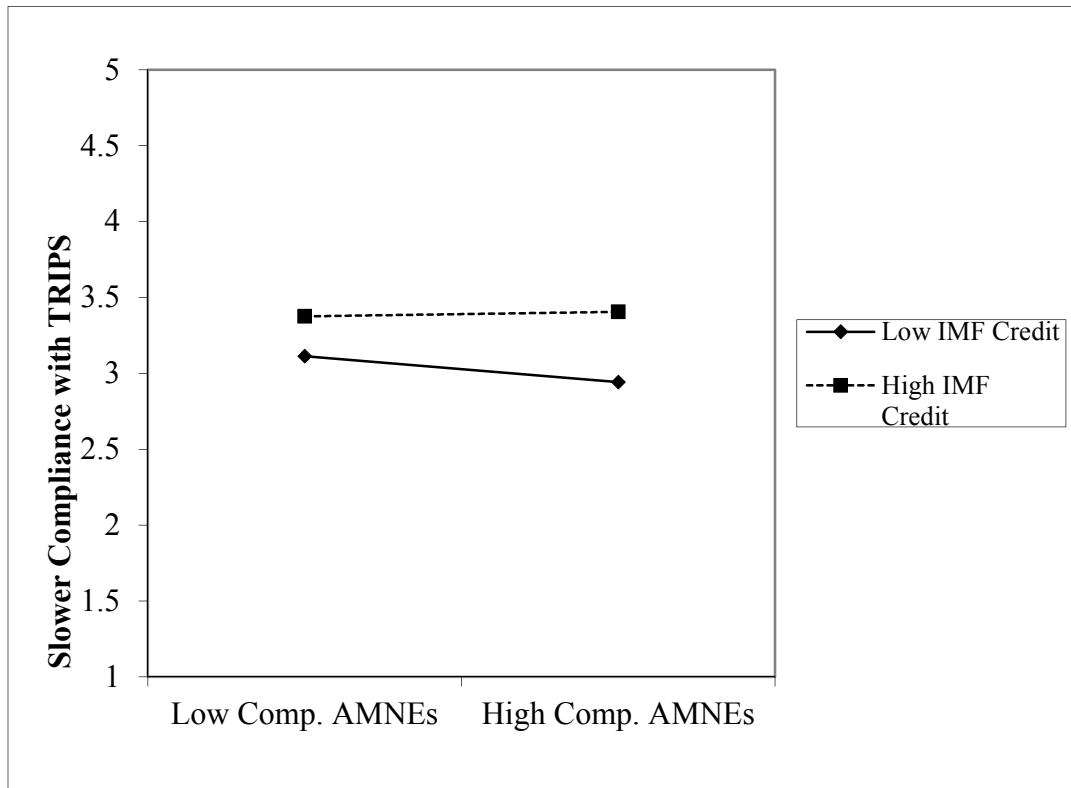


Figure 3.3. Interaction between Dependency to the IMF Credit and AMNE Composition on Rate of TRIPS Compliance

3.5 Discussion

Building our arguments on such a co-evolutionary perspective of emerging country catch-up (Kumaraswamy et al, 2012; Qian, 2007), we investigated the interaction of firm-level innovation capability development with regulatory changes in a longitudinal fashion, which is rare (Fiori, 2002). Our focus was on the IP intensive industries (Delgado et al, 2013) such as the pharmaceutical, electronics, and computer and software industries in developing countries. The developing countries went under many different phases of IP protection levels, which made it possible for us to investigate the process of the institutional change among different countries in different periods of time. Using new institutionalism and evolutionary perspectives, we argued that there is a great variation among countries in terms of the pace of institutional change, and the regulatory evolution can be explained as outcomes of different lobbying efforts by different innovation actors at the NIS of the developing countries.

Firstly, we claimed that local firms will lobby against a fast transition into the higher IP standards. Accordingly, we found positive and significant effect of increasing composition of local firms on a slower transition to TRIPS, suggesting that local firms in a NIS of a developing country, try to influence policies in a way to hinder TRIPS compliance as long as possible. This was the case with India, who waited until the 10-year flexibility period and also introduced amendments during this process.

The Indian pharmaceutical industry developed in several stages largely influenced by government policies that were implemented to improve the country's healthcare sector or to comply with global IP protection regulations. The ratification of the Industrial Licensing Act of 1951 was one of the first governmental regulations and led to the development of a strong public sector with institutions and laboratories (Panagriya, 2008; Kale & Little, 2007). Since then the government actively implemented policies in the industry to support domestic firms and help the national healthcare sector. Especially generic drug innovation through reverse engineering (process improvements of already existing drugs) was supported by these policies, such as the Patent Act of 1970 (Nair, 2008), going counter to the protection of intellectual property. Additionally, the policies were described as being without any direction or regime, loosely deciding upon strategy without any sense of urgency (Nair, 2008).

In 1994, India also signed the TRIPS agreement and started to move away from a sole generics supporting to a new innovation embracing regime that allowed product patents rather than just process improvements. Following the stringent regulations from the WTO, the Indian government amended the Patent Act of 1970 in 1999, 2002 and 2005 (on January 1, 2005 the last day of the 10 year transition period). The amendments in 2002 and 2005 finally allowed product patents and covered both product and process innovation under a 20-year patent term (Haakonsson et al., 2012, Nair, 2008).

We also found that the composition of MNEs in the national innovation system of a developing country has an impact on TRIPS compliance and that the higher the

composition of MNEs, the faster TRIPS compliance is achieved. The pressure by multinational firms is impacting local governments to comply with TRIPS regulations faster. It could also be inferred that the lower the composition of MNEs in the national innovation system of the developing country the less pressure is put on the governments and the more impact domestic firms have on slowing TRIPS compliance.

This was the case with Brazil's faster transition to TRIPS. For Brazil, access to affordable medicine was important due to its rather large low-income population. Therefore, the government was protecting the domestic pharmaceutical industry through tariffs, quotas and also a low level of appropriability regime, which helped it to develop its process/imitation capabilities. However, Brazil had established a national system of innovation institution to foster and enhance the innovation efforts. As a result, Brazil's innovation capabilities somewhat developed, and it has been considered among important generic drug producers along with India and China (Morgan & Fai, 2007).

As an influence from the MNEs that want to penetrate into the Brazil market, the US tried to put pressure on countries that mainly produced generic drugs such as Brazil since the late 1980s. The Congress passed a legislation named "Special 301" with the goal to identify countries with inadequate IP protection. Brazil was put on this list in 1989 and was given 100% tariffs on imports from Brazil (Lanjouw & Cockburn, 2000). This increased stress on Brazil to increase its level of IP protection. Thus, before TRIPS the Brazilian senate discussed rather unsuccessfully a patent bill to

increase IP protection standards (Rozek & Berkowitz, 1998). In line with the TRIPS regulations, Brazil finally gave in to pressures from the US and decided to not capitalize on the 10-year transition period. The country ratified TRIPS in 1997.

We also argued that the supranational institutions have in-direct effect on the pace of institutional change taking place in developing countries. Our results indicate that the dependency to the IMF credit impacts the effect of MNE composition and its already existing influences on the rate of compliance with the TRIPS agreement. In other words, external pressures such as from the IMF or presumably also other supranational institutions strengthens the MNEs pressure on governments to comply quickly with TRIPS.

A good example is what happened during the TRIPS compliance period in Turkey. Starting from 1970s, Turkish drug companies developed generic drug development capabilities and were able to provide high quality generics to the local market. Moreover, the Turkish healthcare sector, with a population reaching to 50 million people in 1995, was considered as big enough to offer lucrative opportunities for foreign entrants. However, the pharmaceutical industry was long protected by tariffs, quotas, price regulations and lack of IP protection, which prevented foreign entry for a long time.

In Turkey, historically the government was the sole buyer of drugs. In the 1990s, the price of generics produced by Turkish pharmaceutical firms was calculated based on the cost the firm announced to the government, which raised a lot of concerns related

to possible self-reporting bias. Therefore, local firms were enjoying “sweet” profits as they were protected against other possible lower cost foreign generic producers. The protection of the local generic producers against competition and the existence of lucrative deals with the government resulted in a lack of motivation towards innovation among local pharmaceutical firms (TOBB, 2012). In addition, the government lacked behind many countries in terms of providing the necessary infrastructure and incentives such as laboratories, research grants, university support to facilitate innovation. There was not a central institution and for a long time, the Turkish pharmaceutical industry possessed strong generic drug development capabilities, while lacking innovation capabilities.

Before TRIPS related talks began, Turkey was in the process of developing an IP protection infrastructure. The Turkish equivalent of a Federal Drug Association (FDA) was established in 1990, and a major regulatory change concerning the new drug development processes was planned. However, even this regulatory change didn't include a protection for the drug as a product. In May 1995, Turkey ratified the TRIPS and only 6 months later it was given the 10-year transition period allowance. The government gave in to pressures from the International Monetary Fund (IMF), as it had experienced a major financial crisis in 1994, which forced it to sign a credit agreement with the IMF.

3.6 Conclusion

In this paper we tried to present a co-evolutionary story of institutional change through institutional entrepreneurship (McGuire et al., 2004) and political activism (Boddeyn & Brewer, 1994; Faccio et al, 2006; Hillman & Hitt, 1999), which is missing within the existing literature (Cantwell et al, 2010; Hoskisson et al, 2013). Through presenting different interactions among endogenous institutions at different levels during the institutional change at the developing countries contexts extends the institutional theory of North (1990) who has argued that actors not only adapt to given institutions, but aim to shape institutions by providing a process mode of two-way interactions (Cantwell et al., 2010; Child, 2005; Kostova et al, 2008). Such a perspective is novel as the prior international business and strategic management literature have not analyzed this process combining the old and new institutionalism (Cantwell et al, 2014; Jandhyala, 2014), especially at contexts where institutions change frequently (Xu & Meyer, 2013). Hence we contribute to calls for papers for cross-fertilization of evolutionary view with the institutional based view of the MNEs (Peng & Wang & Jiang, 2008) and as well as inquires towards analyzing rare instances of coevolution of organizations and institutional environments at multiple levels (Carney & Gedajlovic, 2002; Hoskisson, Wright, Filatotchev & Peng, 2013; Kostova et al, 2008; Lewin & Volberda, 1999).

Considering the developing country context of this paper with a focus on developing countries, the institutional change process and its implications on actors as well as its

path dependency (Libecap, 1989; Demsetz, 1967, 2008; North, 1990; 2005) becomes important. The complexity and importance of institutions and institutional change in developing countries is noteworthy. Institutions play a unique role in developing countries (Li, Tsui, & Weldong, 1999, Lin, 2001) and have influenced the development of these countries.

From an innovation policy perspective, our results suggest that the development of the institutional environment within the developing countries is a complex and endogenous process where different actors have effects on different directions. Hence, the policy makers need to be aware of these competing and complementing forces within the institutional environment to ensure they develop an optimal set of rules and regulations that are conducive to the catch-up process of developing countries. Otherwise, they can end up with implementing sub-optimal standards, which might curtail further development of the developing country.

Our results suggest meaningful lessons for the managers of domestic vs. foreign firms that are active in the innovation system of a developing country as well. As variation among developing countries in their TRIPS compliance decisions indicate, if domestic firms increase their presence within the innovation system, they can slow down the institutional change towards higher IP standards so that they might have more time for transforming their output capabilities to the innovative capabilities. Conversely, if AMNEs increase their presence within the innovation systems of developing countries, they can speed up the compliance to global standards, which

will decrease the uncertainties related to the institutional voids in developing country contexts. In addition, they can lobby the supranational institutions such as the IMF to speed up this process.

Our paper has a number of limitations. First, our presentation of institutional entrepreneurship and political activism by domestic vs AMNEs as mechanisms is limited, since we weren't able to tease out such activities in each country. Future studies can directly measure these activities and do a comparative analysis on the different levels of activism by the actors in the local innovation systems and the policy decisions of the governments. Secondly, we are only investigating the effect of the varying decisions of developing countries in terms of deciding upon the rate of compliance to global standards. For future studies, it could be interesting to see the countries and their catch-up performances affected by optimal vs. sub-optimal policy decisions.

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