POLITICAL STABILITY AND FOREIGN SUBSIDIARY SURVIVAL IN THE PRIMARY INDUSTRIES SECTOR

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DEDICATION

To my mom and dad,

You are both the

NOOR

of my eyes…

ABSTRACT

This thesis investigated the impact of political stability on the survival of foreign direct investments in the primary industries sectors. It is based on the argument that less stable political environments can potentially allow foreign business investors to have more influence in shaping policy in favor of their strategic interests in the primary sector. Using a sample of 753 primary sector investments by Japanese multinational enterprises in existence from 1986 to 2013, I conducted a survival analysis to test my hypothesis as well as the moderating effect of a firm's motives. This research contributes to the literature on political risk for foreign direct investment by building on the observation that, for primary industry investment, political stability has a non-monotonic effect on location attractiveness, which varies according to the specific motives of the foreign investor. Furthermore, the performance implications of political stability are important for multinational enterprise investors and policy makers alike.

Keywords: *Foreign Direct Investment, Purpose of Investment, Primary Sector, Subsidiary Survival.*

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CHAPTER 1: INTRODUCTION

Political instability refers to the degree of volatility, and hence instability, in the policy regime of a state (Henisz, 2000; Jensen, 2006). While encompassing explicit threats to domestic and foreign business, in the form of increasing taxation or outright expropriation of private assets, political instability refers more generally to the pace and extent at which government policy changes. Researchers have argued that multinational investors exhibit a preference for a higher degree of political stability, as it can be considered a factor in reducing the uncertainty of returns from their international investments. However, the evidence has not always supported this positive relationship (e.g. Barassi & Zhou, 2012; Helmy, 2013; Lui, 1985; Wheeler & Mody, 1992). Furthermore, recent research that considers a broader range of investor home countries suggests that in many cases, firms prefer a level of institutional quality more in line with that of their country of origin (Kostova, 1996; Xu & Shenkar, 2002). I argue that the inconsistent evidence is partly dependent upon the nature of the investment itself. For this thesis, I conducted research specifically in the context of primary industry investments, as these are deemed the most sensitive to political uncertainty (Kobrin, 1979). Rather than arguing from the perspective of multinational investors deciding on a location for investment, I instead focused on the performance of investments that have actually been made. Hence, my arguments stem not from managerial perceptions of political stability and the impact of political stability on business, but rather from the impacts that stability level has on the performance of the subsidiary.

To provide further evidence of the impact of political stability on subsidiary performance, I also examined how this relationship changes depending on the investment motives of the multinational investor. Prior research on this topic has been limited by data availability issues, often using the industry of investment as proxy; i.e. retail = market seeking, manufacturing = labor seeking, etc. (Brouthers & Brouthers, 2003; Dhanaraj & Beamish, 2009; Meschi, Phan, & Wassmer, 2016). I overcame this limitation by using survey data—collected from Japanese executives—where one of the questions asks for what purpose(s) a specific overseas subsidiary was established.

Combining the logistics of foreign direct investment (FDI) and institutional economic theories (Cantwell, Dunning, & Lundan, 2010; Dunning, 2006; Dunning & S. M. Lundan, 2008), I argue that moderate levels of political instability allow a firm greater leeway in influencing the evolution of domestic policy. Compared highly stable countries, such environments are generally characterized by greater uncertainty, but multinational investors in the primary industries can substantially reduce that uncertainty through their influence over emerging institutions. Hence, the primary industry subsidiaries of foreign multinational enterprises (MNEs) that have invested in less politically stable countries may exhibit a higher probability of survival. I subjected this prediction to more rigorous evaluation by taking into account the self-reported motives of MNE investors. That is, I predicted that natural resources- and efficiency-seeking investments are associated with higher rates of survival in less politically stable countries, but this relationship is significantly weakened for subsidiaries with market- or asset-seeking investments.

To test these predictions, I used a multilevel mixed-effects parametric survival analysis on a near-population level sample of Japanese overseas direct investments in

primary industries during 1986–2013. These data are collected annually by Japanese publisher Toyo Keizai Inc. (TK) and provide information about the Japanese subsidiaries and parent companies such as the purpose of their investment, the number of expatriates, the size of the parent firms and subsidiaries, industry category, and so forth. The results show that there is a non-linear relationship between political stability and subsidiary survival. The significant and positive linear coefficient shows that a low-to-moderate level of political risk leads to a decrease in subsidiary survival, and the positive and negative coefficient of the quadratic term shows that a high level of political risk decreases the hazard rate (increasing subsidiary survival). In addition, firms that have an efficiency-seeking motive can stay longer in an unstable political environment. In contrast, firms with a market-seeking motive cannot take advantage of political instability in the host country.

This research was intended to contribute primarily to the literature on political hazards and instability, by establishing contingencies in the relationship between political stability and subsidiaries' survival as a main effect, with consideration of the moderating effect of subsidiaries' motives (natural resources-, efficiency-, market-, and asset-seeking). These findings also have the potential to contribute to internalization theory by explicating a new mechanism by which firm-specific assets can *result* from international investment (e.g. Narula & Verbeke, 2015; Rugman, 1981), in addition to being a source of advantage for MNEs to exploit (e.g. Buckley & Casson, 1976; Buckley,1988). Furthermore, this research provides evidence in support of extending FDI theory to include the impact of internalizing non-market failures (Buckley, 2018), such as political instability. Finally, this study seeks to contribute to outlining the boundary conditions on

FDI theory by taking into consideration neglected characteristics of the primary industries, especially the substantial impact of non-market transactions on performance.

As the results of this study show that both low and high levels of political stability provide some advantage for firms, managers may need to consider how to shape policy in the host country based on what is more favorable for the firm. As survival is a criterion for assessing the performance of subsidiaries, considering subsidiary survival can help managers to assess the impact of different levels of uncertainty on firm performance.

CHAPTER 2: LITERATURE REVIEW

2.1 Subsidiary Survival

Subsidiary survival refers to the length of time a subsidiary has remained in operation since its inception (Delios & Beamish, 2001). It is an important dependent variable in FDI research, because subsidiary longevity is deemed a valid indicator of its success, given that financial performance data are rarely available at the subsidiary level and, furthermore, that not all subsidiaries exist to maximize profits (Ariño, 2003; Dossi & Patelli, 2010).

Both subjective and objective criteria are used in assessing subsidiary performance (Geringer & Hebert, 1991). Subjective criteria consist of the manager's point of view about the performance of a firm and the extent to which the firm meets its goals. Since profitability is not always the best indicator of success, e.g. for purely manufacturing subsidiaries without external sales, or for research and development (R&D) units that operate as cost centers, managers can judge firm performance compared to various benchmarks of success. I would still argue that this is an objective measure but could be considered “subject to” a previously established measure. Comparing a firm’s performance to its performance in previous years is not different than conventional measures of success, which include metrics such as sales and profitability growth. Objective indicators of performance include (a) profitability, which refers to return on investment and profit margin; (b) longevity, which refers to subsidiary activity duration; (c) survival, which indicates whether or not the firm continues to operate within the host country; and (d) stability, which refers to the altering the ownership level of the firms. Survival is an important overall indicator of performance because the decision to continue

or exit from a foreign country depends on a firm's level of performance given its specific mandate (Beamish & Lupton, 2009; Park & Ungson, 2001).

Different conceptualizations of performance require different approaches to measurement. *Financial performance* is measured by cost efficiency and profitability (Dossi & Patelli, 2010). This measure is influenced by the institutional characteristics of the host country such as the investment protection offered by the host; tax rates; and factor market characteristics including accessibility to various types of resources, energy, land, etc. The lifetime and stability of contracts is an *operational measurement* (Geringer & Hebert, 1991), while *organizational measurement* refers to the overall assessment of an organization's performance and the extent to which its goals are achieved (Parkhe, 1993). These operational factors enable researchers to imperfectly predict a firm's success (Ariño, 2003).

2.2 Geographic Expansion Modes and their Antecedents

When expanding to a new country, a parent firm has several options—or modes—at its disposable, as depicted in Figure 1. Equity-based and non-equity based expansion modes differ in that only the former involves capital expenditures by foreign and, in some cases, host country firms (Madhok, 1997). Resource commitment is the most important requirement for investing in foreign countries according to the equity-based sub category of entry mode. However, the potential risk, investment return, and environment of the local market should be analyzed before investing in a foreign country (Pan & David, 2000). The choice of entry mode to the global market has always been of

great interest to scholars due to the likely impact of entry mode on the internationalization process, and because it is one of the critical decisions affecting the ultimate success of a firm (Andersen, 1997). Each entry mode has different pros and cons, which in turn are dependent upon the economic motives of the parent firm expanding its operation to each country (Brouthers, Gao, & McNicol, 2008). Given that there are benefits and drawbacks to each type, the matching of expansion mode to firms' strengths and economic motives, along with location attributes, has implications for subsidiary performance and survival.

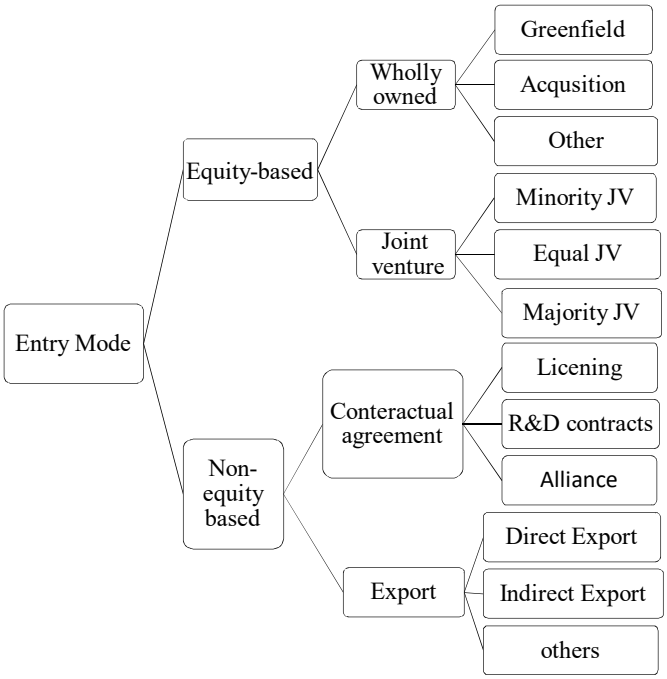

Figure 1: Entry mode taxonomy (Pan & David, 2000)

2.2.1 Wholly-Owned Subsidiaries (WOS)

WOS are legally independent firms entirely owned by a parent firm. A firm that has control over another firm is called a parent firm, and the firm under the parent's control is called a subsidiary (Arora & Fosfuri, 2000). As can be seen in Figure 1, there

are two types of WOS: greenfield investment, which involves building new facilities, and acquisition, which involves acquiring an existing facility, allowing for entry without adding new capacity to the industry (De Sousa, 2000).

2.2.2 International Equity Joint Ventures

In international equity joint venture (IEJV) firms, two or more parent firms contribute capital to the formation of a legally distinct organization. The parent firms share their resources—consisting of knowledge, materials, and technology—and at least one of the parties is situated outside of the country in which the IEJV is formed (Chen & Messner, 2009). There are four steps to implementing an IEJV as an entry mode: (1) evaluating the firm's strategy toward the investment and creating a new venture, (2) choosing a partner, (3) negotiating with partners, and (4) implementing the business (Beamish & Lupton, 2009).

According to the amount of equity (percentage), IEJVs can be placed into three categories: minority IEJV, in which the foreign parent's stake is less than 50%; equal IEJV, in which the partners hold equal shares; and majority IEJV, in which the foreign parent holds more than a 50% share (Pan & David, 2000).

2.3 Antecedents of Subsidiary Survival

Factors that impact a subsidiary's survival can be grouped roughly into subsidiary-specific (size, expatriate staffing levels, and subsidiary age), parent-specific (age, size, parent equity ownership structure, parent experience in the host country), and location-specific (host market growth, intellectual property rights, corporate tax, policy stability, political economy, infrastructure and urbanization, distance cost).

2.3.1 Subsidiary Size

Subsidiary size refers to the amount of investment in the host country, number of employees, or amount of sales. Recent studies results have shown various impacts of subsidiary size on subsidiaries' survival. Some studies have found that subsidiary size has no significant impact on subsidiary survival (e.g. Boeh & Beamish, 2015; Delios & Beamish, 2001; Håkanson & Kappen, 2016), while others have found a positive relationship between size and survival (e.g. Alcantara & Hoshino, 2012; Dhanaraj & Beamish, 2004; Gaur & Lu, 2007; Getachew & Beamish, 2017). One reason that asset size can improve a subsidiary's survival is that assets can be used to cover costs after huge losses; another is that large organizations typically have more powerful institutional ties that help them to adapt to a new environment more easily than smaller firms (Bradley, Aldrich, Shepherd, & Wiklund, 2011).

2.3.2 Expatriate Staffing

The use of expatriates to manage subsidiaries improves subsidiary survival rate (Boeh & Beamish, 2015; Delios & Ensign, 2000). A study of Japanese MNEs by Delios and Bjorkman (2000) shows that surviving subsidiaries had employed at least five Japanese managers, while failed subsidiaries had employed only two, on average. These authors argue that because of the high costs of employing Japanese managers, most subsidiaries prefer to use local managers or a small number of Japanese managers in existing subsidiaries. However, having a reduced number of Japanese expatriates leads to an increased exit rate, for four reasons (Beamish & Inkpen, 1998). First, Japanese firms are unwilling to post local managers to subsidiaries because cross-cultural adjustment to

the Japanese work culture is very difficult. Second, Japanese expatriates are better aligned with the motives of the parent firm and hence can more efficiently control and coordinate knowledge transfer to the subsidiaries (Delios & Bjorkman, 2000). Third, in a more institutionally 'distant' environment, parent firms may prefer expatriates, believing they can transfer managerial practices and parent firm capabilities more efficiently (Gaur, Delios, & Singh, 2007). Finally, expatriates may have more incentives to keep the subsidiary alive (Boeh & Beamish, 2015).

2.3.3 Subsidiary Age

According to the literature, the chances of survival for a young subsidiary are less than those of subsidiaries that have been active for at least a couple years (Carroll & Delacroix, 1982). There is consistently a significant and positive relationship between subsidiary age and subsidiary survival (Alcantara & Hoshino, 2012; Delios & Beamish, 2001; Getachew & Beamish, 2017). These findings show that the more years subsidiaries operate in foreign markets, the lower their chances of failure, as their experience helps them to gain knowledge of the local market and to tackle environmental challenges. A summary of subsidiary characteristics is given in Table 1.

Table 1
Summary of Subsidiary Characteristics' Variables

Variable	Definition	Findings
Subsidiary size	Capital invested in the foreign country/parent firm assets	Not significant (Boeh & Beamish, 2015; Håkanson & Kappen, 2016), positively significant (Alcantara & Hoshino, 2012; Getachew & Beamish, 2017)
Subsidiary age	Number of years the parent firm has been established	Not significant, positively significant (Alcantara & Hoshino, 2012; Delios & Beamish, 2001)
Expatriate staffing	Number of expatriates that work in foreign countries	Positively significant (Delios & Ensign, 2000; Gaur et al., 2007)

2.3.4 Parent Size

Firm size is defined as parent firm assets. Larger parent firms are better able to cover the incremental costs of conducting business in foreign countries, including marketing costs, costs of applying for patents, and negotiating contracts. Hence, a positive relationship is expected between firm size and subsidiary survival (Agarwal & Ramaswami, 1992; Alcantara & Hoshino, 2012; Hood & Young, 1979). Others have argued for a positive relationship between parent size and the chance of subsidiary closure "…due to the flexibility that they enjoy in moving their subsidiaries within the country, or their propensity to consolidate multiple subsidiaries within the country or region" (Dhanaraj & Beamish, 2004, p. 300).

2.3.5 Parent Age

Parent age as subsidiary age has been measured in some studies as the number of years a firm has been operating. Some findings show no significant relationship between the age of a parent firm and its subsidiary's survival (Boeh & Beamish, 2015).

2.3.6 Parent Equity Ownership Structure

Equity ownership is the amount of resources devoted to a subsidiary. Equity reflects the level of commitment, extent of control, and decision-making ability of the parent firm (Anderson & Gatignon, 1986; Dhanaraj & Beamish, 2004; Getachew & Beamish, 2017). Less than 20% ownership will increase the chance of a subsidiary's failure; the mortality rate of firms with more than 80% ownership is close to WOS (Dhanaraj & Beamish, 2004). A higher level of commitment is a result of a higher level of equity, and this in turn leads to increased attention by foreign managers on the local subsidiary (Dhanaraj & Beamish, 2004). Along the same vein, the selection of executive board members for subsidiaries is partly determined by the level of ownership of each partner, thus increasing the effective control of the subsidiary by those partners (Mjoen & Tallman, 1997) .

2.3.7 Parent Experience in the Host Country

The number of years that parent firms have been managing foreign subsidiaries, and the number of countries in which they possess significant investments constitute its international experience. The results of various studies reveal a positive significant relationship between experience and subsidiaries' survival, since this relationship reflects greater knowledge about local market conditions, local market preferences, and local

institutional systems of the host country (Boeh & Beamish, 2015; Gaur & Lu, 2007; Meschi et al., 2016). A summary of firm characteristics is given in Table 2.

Table 2
Summary of Firm Characteristic Variables

Variables	Definition	Findings
Parent size	Parent firm assets	Positively significant (Agarwal & Ramaswami, 1992; Alcantara & Hoshino, 2012) Negatively significant (Dhanaraj & Beamish, 2004)
Parent age	Years a firm has been operating	Positively significant (Boeh & Beamish, 2015)
Parent equity ownership structure	Amount of resources that local and foreign firms devoted to the investment	Positively significant (Dhanaraj & Beamish, 2004; Mjoen & Tallman, 1997)
Parent experience in the host country	Years of parent firms' international experience	Positively significant (Gaur et al., 2007; Meschi et al., 2016)

2.3.8 Host Economy Growth and Openness

Local market growth provides opportunities for firms to match the sales growth of existing products, as well as introduce new products. Although subsidiary survival is positively related to the size and attractiveness of the local market (e.g. a wealthier and larger economy is more attractive for FDI (Brouthers et al., 2008)), the degree of product matching with the local market further increases the likelihood of subsidiary survival (Hakanson, 1992; Håkanson & Kappen, 2016).

Real gross domestic product (GDP) growth refers to economic growth during different periods, adjusted for interest rates and price inflation (Lepenies, 2016). Measuring these macroeconomic changes in a host country represents a negative relationship between real GDP growth and subsidiary survival rate (Alcantara &

Hoshino, 2012). Price variation in every economy is demonstrated by host economic growth, so the less this indicator is, the less the chance is of attracting foreign investment, and as a result, the chance of survival decreases.

Openness refers to all firms' activities in sharing their products and knowledge with other firms around the world. Also, it shows the degree of regulation on private business activity, both domestic and abroad (Ahimbisibwe, Ntayi, & Ngoma, 2013). One sign of an open economy is export orientation, and most foreign firms tend to invest in more export-oriented economies (Singh & Jun, 1999). There are two types of export orientation: (1) exporting goods to the home country, in which the aim is to lower production costs; and (2) exporting production from the host country to a third country, which is motivated mostly by efficiency seeking, but also by potentially working around home country restrictions, such as a trade embargo (Kumar, 2006). Since export intensity shows a country's infrastructure, the higher the rate of export is, the greater the chance is of creating a new venture (Barry, 2016; Meschi et al., 2016).

2.3.9 Intellectual Property Rights

Intellectual property rights (IPR) allow a person or a firm to appropriate value from patents, trademarks, and brands (Arai, 2000). The impact of IPR on subsidiary survival varies. Weak IPR make it difficult for R&D units to continue their operations, since it is possible their local competitors will copy their technological knowledge (Schmiele, 2013). Measuring this relationship in a study, Håkanson and Kappen (2016) show that there is no significant relationship between IPR and subsidiary survival.

2.3.10 Corporate Tax Rate

Corporate tax rates determine the amount of tax a firm pays in the state that it is situated, and high tax rates can deter investment in the first place, while rising rates may lead to subsidiary exit (Boeh & Beamish, 2015). Studies have shown a positive relationship between corporate tax rates and the chance of failure, such that a 1% tax rate increase leads to a 5% decrease in subsidiary survival (Boeh & Beamish, 2015).

2.3.11 Infrastructure and Urbanization

Factors such as population size, physical and financial infrastructures, and degree of urbanization are indicators of a country's level of economic development (Meschi et al., 2016). Urbanization is defined as the number of people who live in the urban area of a country (Cohen, 2015). This factor indicates the infrastructure that is available in a host country needed by the foreign investment, as large and concentrated cities provide opportunities for investors to more easily find skilled labor (Behname, 2013). On the other hand, urbanization introduces niche markets, thereby increasing the likelihood of attracting new investors (Crenshaw, 1991; Root & Ahmed, 1979).

2.3.12 Distance Cost

Distance cost refers to the expenditures that firms must pay because of travel time and geographic or cultural differences between home and host countries (Boeh & Beamish, 2015; Zaheer, Schomaker, & Nachum, 2012). Time distance (i.e. travel time) is one factor that negatively influences subsidiary performance (Boeh & Beamish, 2015). As time distance increases, communication, knowledge transfer, responding to market

changes, and other managerial issues become more difficult and hence costly. The resulting poorer performance increases the chance of subsidiary failure (Boeh & Beamish, 2015).

Table 3
Summary of Country Characteristic Variables

Variable	Definition	Findings
Host country economy growth and openness	Includes: • Local market attractiveness: To what extent characteristics of the market, such as its size, number of customers, etc., attract foreign investors • GDP growth: Economic growth during different periods according to price changes • Export orientation: The extent to which infrastructures are provided for exportation	• Local attractiveness: positively significant (Brouthers et al., 2008) • GDP growth: Negatively significant (Alcantara & Hoshino, 2012) • Export orientations: Positively significant (Kumar, 2006)
Intellectual property rights (IPR)	The rights given to a person for creating something particular	Not significant (Håkanson & Kappen, 2016), positively significant (Schmiele, 2013)
Corporate tax rate	The income tax rate of subsidiaries in the province they are located	Negatively significant (Boeh & Beamish, 2015)
Infrastructure and urbanization	The number of people who live in the urban area of a country	Positively significant (Meschi et al., 2016; Resnick, 2001)
Distance costs	The expenditures firms must pay because of time and geographic or cultural differences between home and host countries	Negatively significant (Boeh & Beamish, 2015)

CHAPTER 3: THEORETICAL MODEL

3.1 Foreign Direct Investment

Establishing a business in a foreign country by investing in facilities that grant control to a parent firm is called foreign direct investment (FDI) (Hymer, 1960). Various theories try to describe FDI from an economic point of view (Peter J Buckley & Hashai, 2009). The first category of theories is based on observed departures from the general equilibrium models of orthodox economics, which would preclude the existence of multinational enterprises. Although the underlying assumption of this category is that markets are imperfect, its core focus remains the explication of an observed pattern of production, consumption, and trade at the country level rather than the firm level (Grossman & Helpman, 2002; Markusen, 1984). The second category of theories considers the partial equilibrium models in heterodox economics. This category shows how the motivations of firms lead to a choice in different types of entry modes (Dunning, 1988). Dunning's eclectic paradigm is representative of this category (Peter J Buckley & Hashai, 2009). Dunning states:

> It [the eclectic paradigm] was meant to convey the idea that a full explanation of the transaction activities of enterprises needs to draw upon several strands of economics theory and that foreign direct investment economic involvement, each of which is determined by a number of common factors. (Dunning, 1988, p. 1).

The eclectic paradigm (or OLI model) was developed in the context of manufacturing firms, but is considered general enough to extend to the primary industry as well (Dunning, 2001). The eclectic theory of firm internationalization provides a broad umbrella under which the motive for international expansion, location of investment, and

type of investment can all be explained. The theory combines two complementary logics, internalization advantage, and transaction cost economizing. The assumption is that when market-based transaction costs (i.e. contract negotiation, monitoring, and enforcement costs) are higher, conducting the transaction within the hierarchical control of a firm is more efficient (Williamson, 1981). Internalization advantages are especially relevant when value creation relies on the proprietary knowledge of the firm (Kogut & Zander, 1993; Verbeke, 2003). Hence, the resulting paradigm is useful in explaining why firms invest in foreign countries (ownership advantages), where they invest (location advantages), and how they invest (internalization advantages) (Dunning &Lundan, 2008).

3.2 Ownership Advantages

The "O" in OLI stands for ownership advantages of the firm. It refers to the advantages conferred by a firm's tangible and intangible assets such as technology, managerial expertise, distinctive products, and so forth (Verbeke, 2003). These advantages are possessed by firms that have the capability of exploiting them in foreign contexts, without reducing their effectiveness, while also covering the additional costs of adapting to foreign institutional characteristics (Dunning, 1988).

O advantages established were originally considered static (Dunning, 1988), emphasizing the capabilities of firms to serve foreign markets with existing products (Dunning, 1977). Later, O advantages were considered to be more dynamic in the emerging global economy, as learning ability, experience, and knowledge-intensive assets increasingly constituted a firm's most important ownership advantages (Buckley, 2011; Dunning, 2000b).

Market-seeking and resource-seeking motives of investors are more closely related to the first generation of the static O advantages, while strategic asset seeking and efficiency seeking are more closely related to dynamic capabilities of the MNE (Dunning & Lundan, 2010). Hence, based on the type of industry or host country characteristics, firms will exploit one or both of these types of ownership advantages (Dunning, 2000a).

3.3 Locational Advantages

The "L" in OLI stands for location advantages, and describes the country factor and institutional characteristics of a potential location that have economic implications for a firm. To identify the best location, market risk, and investment potential, the culture, production costs, and infrastructures of the host country are among the many crucial selection criteria. Earlier research emphasized the geographical advantages and one particular activity that added value to the process, while political risks, uncertainties, regulations, exchange rates, and so forth are secondary considerations that add to or detract from the expected value of the investment (Dunning, 2000a).

There are some general differences between the institutional environments of developing and developed countries that impact their attractiveness for investment. These include top-down and bottom-up hierarchical structures, civic norms, social capital, exchange rates, political issues, and government policies; these are considered the main factors in attracting foreign investors (Dunning & Lundan, 2008). Over time, as these economies increasingly emphasize knowledge assets for building their economies, MNEs derive advantages from their learning processes, knowledge, and technological capabilities to offset the additional costs of addressing different magnitudes and patterns

of demand, transportation costs, and so forth in serving foreign markets (Dunning, 2000a).

3.4 Internalization Advantages

The "I" in OLI stands for the internalization advantages of the firm resulting from the economization of transaction costs, which in turn explains how a multinational firm chooses to operate in the host country The way a multinational firm operates in the host country depends on the relative magnitudes of transaction costs in the market versus within the firm. Colloquially referred to as the 'make or buy' decision, internalization is today considered less of a binary choice. Firms engage in varying degrees of internalization through joint ventures with local and/or foreign partners, as well as engaging in alliance capitalism, where appropriate. All of these decisions are considered to be a result of the characteristics of the transactions themselves (Dunning, 2001).

Based on the general equilibrium economic theory, with its assumption of perfect markets, it does not matter whether a part is made internally or externally, as it will cost the same. In the presence of market imperfections (factor immobility, contracting costs, knowledge asymmetries, etc.), contracting for a part internally or externally involves different transaction costs. Traditionally, strategy researchers assume that market-based transactions should be preferred except where transaction costs are abnormally high.

Internalization theory states that remaining in the foreign market is dependent on the changing balance between the transaction costs and the coordination costs of the investment. Internalization can lead to new ownership advantages if the investment provides new marketing or managerial capabilities to the parent company, adds to its

knowledge stock, improves its production processes, and/or reduces its cost and risk; in such cases, continued investment in the foreign market is warranted (Dunning, 2000a; Fina & Rugman, 1996).

3.5 FDI Motives

The Relevance or exploitability of ownership advantages, location of investment, and mode of internalization are all dependent on the MNE's investment motives (Benito, 2015). Market seeking, natural resource seeking, efficiency seeking, and strategic asset seeking are the four conventional FDI motives (Dunning, 1988; Dunning, 2000a). *Market seeking* addresses opportunities for foreign countries to exploit economies of scale or extend product lifecycles through foreign sales (Narula & Dunning, 2000). The size and affluence of the local market, as well as the firm's potential growth trajectory are all crucial factors to consider when market seeking is the motive for entering a foreign country. *Natural resources seeking* refers to the need to access natural resources that are scarce in the home country but that the target country has in abundance (Moolman, Roos, Le Roux, & Du Toit, 2006; Narula & Dunning, 2000). The aim of this motive is to find the most efficient source of resources to support production by the parent firm or sell to a third firm (Cui, Meyer, & Hu, 2014). *Efficiency seeking* pursues two types of objectives: one is "designed to take advantage of differences in the availability and cost of traditional factor endowments," and the other is "designed to take advantage of the economies of scale and scope, and of differences in consumer tastes and supply capabilities" (Dunning & Lundan, 2008, p. 52). *Strategic asset seeking* seeks to create long-term advantages by transferring knowledge to the host country in the form of both technological and managerial knowledge and capabilities (Meyer, 2015). To extend the idea of strategic

assets seeking, two categories have been introduced: seeking to internalize knowledge assets, and capitalizing on preferential treatment and investment incentives in the host country. Through the first form of asset seeking, competency enhancing subsidiaries are established to serve a more exploratory function in knowledge creation, rather than simply exploiting the ownership advantages of the parent company (Cantwell & Mudambi, 2005).

3.6 Political Stability

Political stability is established as an important location characteristic that can impact the FDI attractiveness of a country and moderate the realization of the intended benefits of that investment (Cuervo-Cazurra, Maloney, & Manrakhan, 2007; Henisz, 2000). I use a comprehensive definition for political stability in this thesis, consisting of factors related to both political risk and uncertainty. High political risk describes a highly unpredictable business environment, characterized by large and abrupt changes in taxation, contract law, policies on expropriation, and so on. (Henisz, 2000; Kobrin, 1979). Political risk and stability refer, respectively, to "the probability of occurrence of an undesired political event(s) and the uncertainty generated by inadequate information concerning the occurrence of such an event(s)" (Haendel, 1975 p. 44). In other words, risk is the probability of a generally unfavorable event occurring, while uncertainty is the lack of knowledge about that level of risk. The former can be directly included in a formal analysis of the costs and benefits of investment, while the latter is more likely to reveal itself after the investment has been made. Political stability levels therefore impact the FDI decision making process. First, investing in countries that suffer from political instability creates difficulties for investors in determining expectation on returns

(Crowley & Loviscek, 2002). Second, economic growth is hampered by political instability, which damages the value of the host country currency and consequently reduces the value of invested assets as well as investment profitability (Keefer & Knack, 2002).

CHAPTER 4: HYPOTHESES

4.1 Political Stability and Subsidiary Survival

In the case of high stability, firms enter a country with a better understanding of the 'rules of the game' (North, 1990), and these rules are reliable and not expected to be subject to frequent or substantive changes. Highly stable environments reduce the risk of expropriation faced by firms (Henisz, 2000). Also, high stability shows that the government has the power to protect property rights, and parent firms can rely on the contract to support their unique knowledge or technology (Weingast, 1993). Given that these forces all have a bearing on the performance of a subsidiary, investments in the most stable policy environments are expected to have high survival rates.

However, the combination of the risk and the uncertainty that are produced by political instability can impact both the expected and actual returns from an investment, such that they impact both the location choice and subsequent performance of FDI. When government policy is more volatile, negotiation can be a more effective tool for incumbent foreign firms to shape policy. This allows them to improve their competitiveness, for example by discouraging new competitors from entering the market. One example is the Toyota Motor Corporation's support for entry barriers to the North American auto industry. Specifically, Toyota supported foreign competitors' bid to remove prohibitively high import tariffs that had already induced it to enter the North American market via import substitution. As a result, Toyota has continued to enjoy a dominant position as a strong regional competitor in this vital segment of the global auto industry.

Negotiations take place between many stakeholders and interest groups. Interest groups can help firms gain concessions, such as tax sheltering in exchange for enhanced working conditions. In the extreme, these negotiations could involve bribery and corruption. In situations where corruption is dominant, regulations and agreements have different impacts as a result of varying interpretations and the arbitrary enforcement of laws (Rodriguez, Uhlenbruck, & Eden, 2005; Uhlenbruck, Rodriguez, Doh, & Eden, 2006). Therefore, managers can take advantage of policy uncertainty and risk, helping firms shape policies in their favor. Also, policy uncertainty can ease the process of securing government contracts, licenses, and access to information, which are especially impactful in high-rent industries like natural resource extraction (Kolstad & Wiig, 2013).

In summary, a highly stable political environment provides contractual provisions that are reliable, and thus it protects foreign firms' investments, improving their survival. However, the opportunity to negotiate with governments creates more flexibility for firms to shape the policy environment based on their interests. As a result, moderate levels of political stability can help firms to survive in the foreign market. Therefore, I argue:

> Hypothesis 1: *The relationship between subsidiary survival and political stability has a curvilinear (U-shaped) relationship: The lowest and highest levels of stability are associated with higher survival probability, while moderate levels of stability are associated with lower survival probability.*

4.2 Moderating Effect of Natural Resources-Seeking Motives

According to internalization theory, firms select their target country based on the extent to which a country will enable them to achieve their economic goals (Buckley & Casson, 1976). For investing in natural resources industries, resource seeking is the traditional and most obvious motive (Jones, 2005). Cheaper or more accessible resources are the main reason behind investing in a foreign country.

Most countries rich in natural resources are closely tied to the global economy and seek FDI to build extractive industries. Relatively few countries—among them Kuwait, Saudi Arabia, and Mexico—have strong domestic competitors (Asiedu, 2013), as natural resources industries typically require large, complementary investments in infrastructure, technological capabilities, knowledgeable employees, and high-risk exploration, making investment in this industry too resource-intensive for purely domestic firms, thus affording opportunities for foreign multinationals that can better internalize those costs, with the cooperation of the government. Thus, the main consideration is the level of technological development in the host countries; if the host country is not developed to the point where the resources can be extracted efficiently, then the firm has to exploit its knowledge assets or technological assets within the organization. However, as these products should follow specific standards that are determined by industry regulators, not the individual firms (Casarin, Lazzarini, & Vassolo, 2019), offsetting the exploitation of their firm-specific assets are the costs of regulatory compliance and host country fiscal policy.

Low stability (high instability) introduces added contracting costs, incurred to reduce policy uncertainty. However, moderate instability can benefit the firm by allowing it to participate in shaping emergent policy regimes. Favorable awarding of contracts, concessions (Hall, 1999), and cooperation to achieve illegal goals are examples of ease of access to favorable resources (Kolstad & Wiig, 2013). Whereas a highly stable policy environment may evolve towards greater sharing of investment proceeds among local stakeholders and the general population, MNEs can possibly retain more returns by sharing them with a more select—and usually powerful—set of stakeholders. Overall, this leads to a less complex, and hence less costly, bargaining environment. I argue that political stability will have a stronger impact on subsidiary survival in investments with a natural resources-seeking motive:

> Hypothesis 2a: *The curvilinear relationship between political stability and subsidiary survival will be stronger when a firm has a resources-seeking motive: the negative relationship between low to moderate stability and survival, and the positive relationship between moderate to high stability are both steeper.*

4.3 Moderating Effect of Efficiency-Seeking Motives

Efficiency-seeking investment motives involve economizing on production by rationalizing production to exploit economies of scale and accessing low-cost factors where firms reside. This motive helps firms to improve their productivity by reducing production process costs (Meyer, 2015). For firms making these investments, cost

economizing is the most important objective (Dunning, 2000a; Lupton, Jiang, Escobar, & Jiménez, 2018).

Efficiency seeking is often related to market seeking as firms try to produce in the low-cost country and sell in the high-cost country (Dunning & Lundan, 2008). In extraction industries, transportation and distribution costs are some of the most important considerations for an MNE, along with labor, product, and environmental regulations. When a country suffers from an unstable political environment, risks and/or conflict generated by political uncertainty generally lead to increased transportation and distribution costs (Miroux, 2009). To overcome these costs, firms can take part in the process of establishing regulations, and even the development of infrastructure necessary to improve access to natural resources. Illegal payment methods, such as paying cash to create a contract, paying bribes to access raw materials with government subsidies, or paying a lower interest rate, are used for reducing the negative impact of policy changes (Hall, 1999). I therefore expect a stronger curvilinear relationship—similar to investments with natural resources-seeking motives—between political stability and subsidiary survival, where reduced political stability will lead to an increase in survival, and argue that Hypothesis 2b has a similar relationship to Hypothesis 2a and the natural resources-seeking motive:

> Hypothesis 2b: *The curvilinear relationship between political stability and subsidiary survival will be stronger when a firm has an efficiency-seeking motive (similar to when a firm has a natural resources-seeking motive).*

4.4 Moderating Effect of Market-Seeking Motives

Market size and the degree of a market's development are the top priority for market-seeking investments, while labor and transportation costs are secondary priorities in evaluating a foreign location (Makino, Lau, & Yeh, 2002). Less stable policy environments lead to lower economic growth, which in turn leads to lower market attractiveness. Each of these four motives impact a specific segment of the supply chain, and market seeking relates to the distribution of products into a new market. This stage involves greater interfaces with suppliers, distributers, and final costumers (Hakkala, Norbäck, & Svaleryd, 2008), and political instability in a host market tends to create difficulties for firms in building their distribution network, as a result of an environment of lower trust overall and norms of reciprocity (Monteiro, Niklas, & Julian, 2008). Finding a trusted network increases contracting costs with supply chain actors.

The main effect in this thesis is that both high and low political stability have a negative impact on subsidiary survival. For market-seeking motives, firms are more concerned about consumers, and a highly unstable political environment is not suitable for building markets. Companies that have a market-seeking motive therefore will experience a weaker negative relationship between low to moderate political stability and subsidiary survival, and a stronger positive relationship between moderate to high stability and subsidiary survival. I therefore predict:

> Hypothesis 2c: *The curvilinear relationship between political stability and subsidiary survival will be weaker when a company has a market-seeking motive: low to moderate levels of stability are associated with lower*

survival probability, while the positive relationship between moderate to high levels of stability and survival remains the same or strengthens.

4.5 Moderating Effect of Strategic-Assets-Seeking Motives

Dunning defined the asset-seeking motive as follows: "to create or gain access to resources and capabilities that complement … existing core competencies" (Dunning, 1988, p. 135). A range of opportunities encompass the assets that firms seek according to this motive, including preferential treatment by governments, strengthening the function of headquarters, extending the knowledge base, or expanding R&D. Each of these factors will likely have a different impact on the relationship between political stability and subsidiary survival, and the effect depends on the nature of the asset being sought. In this research, based on the dataset, three types of purposes are mentioned more than others by managers: the collection of information; knowledge seeking; research, development, and product planning; and expansion into a new business.

In regards to knowledge assets and human resources, countries with less stable governments tend to be at a disadvantage. Firms with strategic-asset-seeking motives tend to improve their knowledge and competencies, thus educated and skillful employees and the possibility of knowledge sharing between employees are examples of firms' objectives with the strategic-asset-seeking motive. As lower political stability tends to lead to a situation in which governments provide fewer educational resources to a more limited number of people, the pool of educated and highly skilled employees is reduced. This limited pool of knowledgeable employees leads to increasing demand for them, thus

increasing their wages. Indeed, this is part of the reason that firms from countries with greater technological development capabilities tend to dominate these industries; they are able to extract resources more efficiently. Thus, if a firm does have a strategic-asset-seeking motive, in the natural resources industry or otherwise, highly unstable political environments are not very conducive to fulfilling that motive.

I therefore expect a weaker curvilinear relationship, similar to the case of market seeking, between low to moderate political stability and subsidiary survival, and a stronger positive relationship between moderate to high political stability and subsidiary survival in the case of an asset-seeking investment.

> Hypothesis 2d: *The curvilinear relationship between political stability and subsidiary survival will be weaker when a company has an asset-seeking motive: the lowest levels of stability are associated with lower survival probability while the positive relationship between moderate to high levels of stability and survival strengthens.*

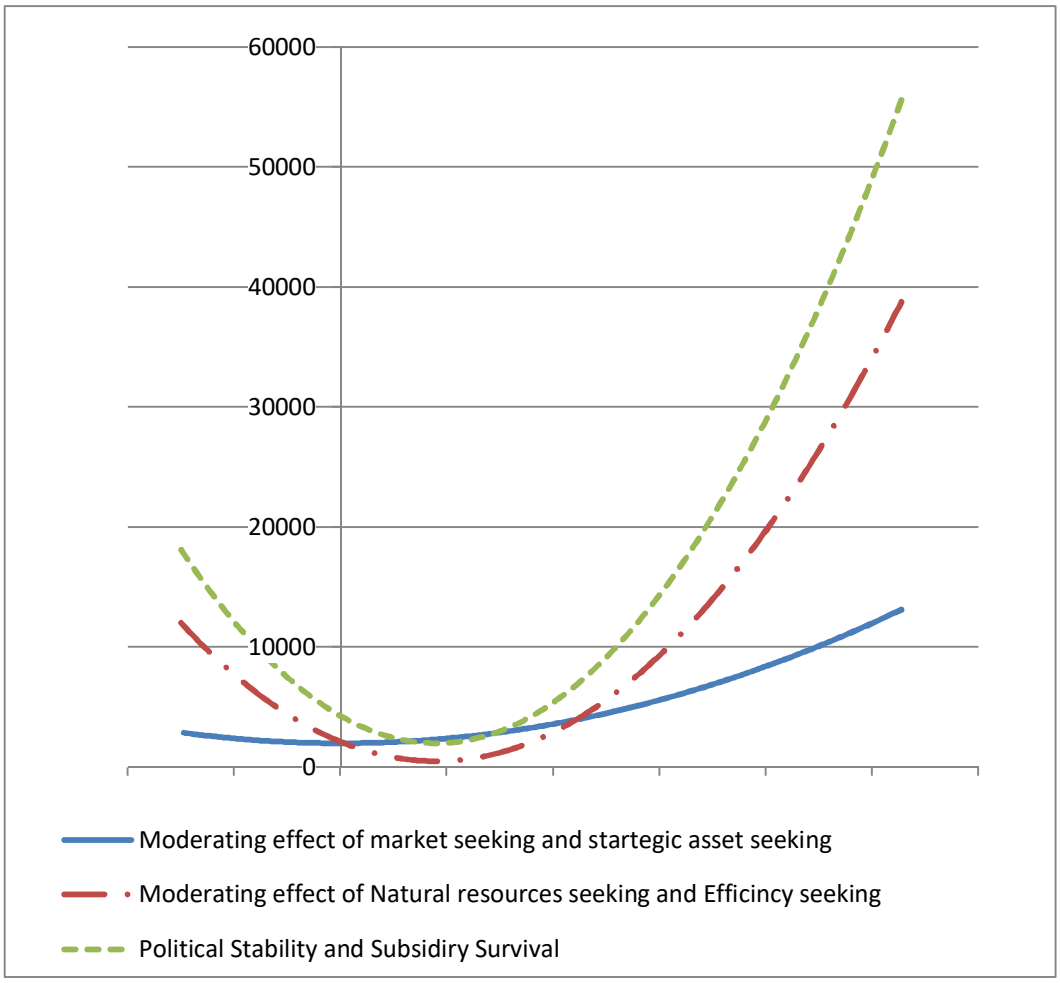

Figure 2: Hypothesized effect between political stability and subsidiary survival

CHAPTER 5: METHODOLOGY

5.1 Data Source

The TK dataset was used to test the hypotheses. This dataset, updated annually, provides information about Japanese firms' investment in foreign countries. This dataset, which was gathered through interviews with general managers, provides information such as the name of the firm, duration of activity, start date, exit date, type of industry, parent firms, purpose of investment, and so on about almost all Japanese firms.

The sample for this study consists of 6,082 observations, and includes all Japanese firms that invested in the primary sector industries in 65 foreign countries from 1986 to 2013. As the ID (KSF affiliate code) of 1,120 subsidiaries were not reported in this dataset, they were not included in the analysis. Therefore, the final number of observations is 5,726 subsidiaries. Country names and the frequency of investment in each year are shown in Table 4.

Table 4
Name of Countries and Frequency of Investment

Country	Frequency	Country	Frequency	Country	Frequency
Argentina	53	India	41	Korea	30
Australia	1,230	Iran	12	Indonesia	269
Bangladesh	33	Jamaica	11	Singapore	70
Barbados	4	Kazakhstan	8	Philippines	174
Bermuda	13	Thailand	140	Russia	9
Bolivia	6	Laos	10	Vietnam	116
Brazil	280	Liberia	8	Saudi Arabia	4
British Virgin Islands	8	Madagascar	34	Senegal	6
Brunei Darussalam	18	Malaysia	74	Solomon Islands	17
Canada	307	Mexico	59	South Africa	40
Cayman Islands	16	Morocco	8	Spain	46
Chile	240	Mozambique	20	Sri Lanka	5
Colombia	14	Myanmar	13	Surinam	12

Congo (DR)	10	Netherlands	222	Taiwan	9
Costa Rica	12	New Caledonia	25	Trinidad	1
Cote d'Ivoire	6	New Zealand	163	Turkey	34
Croatia	2	Niger	24	UAE	68
Denmark	15	Nigeria	9	UK	159
Ecuador	7	Norway	41	US	759
France	18	Pakistan	2	Vanuatu	11
Germany	2	Panama	33	Venezuela	3
Ghana	3	Guinea	12		
Guam	1	Paraguay	10		
Guatemala	20	China	485		
Guyana	2	Peru	48		
Hong Kong	36	Qatar	5		

5.2 Operationalization of Variables

5.2.1 Dependent Variable

The dependent variable for this thesis is the exit of Japanese subsidiaries in the natural resource sectors. As the survival analysis measures time to an event in this study, the event is exit. This measure is a binary variable; those subsidiaries not in the TK dataset before 2013 are coded as one (the event happened to them), and those subsidiaries whose names are still available by the 2013 edition of the dataset are considered as censored data and coded as zero. The reason for this is that we do not have enough information to confirm that they left the country after 2013 or that they continued to survive in the host country.

5.2.2 Independent variable

The main independent variable in this study is political stability, which was drawn from The PRS Group database. The PRS Group dataset provides this information based on two methodologies. The first is the political risk service, which calculates political risk

based on exchange rate policies, the general political environment, and tariffs. The second methodology, called the International Country Risk Guide (ICRG), measures political events and considers how these events impact factors such as GDP, inflation, and the stability of the exchange rate. The result of the combination of these two methodologies is the rate of countries' risk (PRS group, n.d.). This content domain was selected by The PRS Group specifically to address the concerns of foreign direct investors.

5.2.3 Motives as Moderators

The purposes behind investing in host countries stated by managers in the TK dataset are categorized according to the literature, based on four motives (Chrysostome & Lupton, 2011; Dunning, 2000a), as depicted in Table 5.

Table 5
Investment Purpose Categories

Seeking Category	Investment Purpose
Natural resources seeking	Resources and materials
Market seeking	Constriction of international distribution network
	Local market expansion
Efficiency seeking	Labor seeking
	Reverse imports to Japan
	Follow customers, suppliers, and related firms
	Export to third countries
	Construction of international production network
Strategic asset seeking	Collection of information, knowledge seeking, royalty
	Research, development, and product planning
	Expansion into new business

Source: Toyo Keizai

5.2.4 Control Variables

Several control variables were included based on prior studies of FDI performance and survival. GDP growth measures the rate of changes in living standards of each country will be controlled by the GDP per capita; this measure is also used as a proxy for

labor costs (Mayer, Méjean, & Nefussi, 2010). Population is considered as a proxy measure for labor supply (Mayer et al., 2010). The openness to trade index, which reflects the tendency for import and export, will be measured by the Trade Ratio drawn from World Trade Organization (WTO) (Delios & Beamish, 2001; Meschi et al., 2016). To control the general FDI attractiveness of each country for investors, FDI net inflows were used (Brouthers et al., 2008). Descriptive statistics of the measures that were used for analyzing hazards in the statistic model are summarized in Table 6.

Table 6
Summary Statistics of the Main Sample

Variables	Obs.	Mean	Std. Dev.	Min	Max
Event (= exit)	5,635	.952	0.829	0	1
Natural resource seeking	5,635	0.476	0.5	0	1
Efficiency seeking	5,635	0.301	0.459	0	1
Market seeking	5,635	0.142	0.349	0	1
Strategic asset seeking	5,635	0.155	0.362	0	1
Country risk	5,614	75.935	8.24	30	93
FDI inflows	5,626	3.925	7.421	-33.846	103.338
Trade ratio	5,635	69.132	39.938	0.168	442.62
Population	5,626	214.19	914.497	2.25	7714.702
GDP growth	5,612	63.768	2004.046	-13.127	70396.82
GDP per capita	5,610	21949.62	19658.94	102.645	103059.2

5.3 Analytical Approach

A mixed effects parametric survival model was used to predict the probability of occurrence of a time-dependent event (subsidiary exit), based on a set of predictors (Austin, 2017) and dependent upon a set of moderators (purposes of investment). The event modeled was the time to subsidiaries' exit during a span of 26 years from 1986 to 2013, with left censoring. The probability of entering and leaving the study is categorized

into three groups. The first group entered at the start of the observation period (1986), but either did not survive or disappeared within the middle of the time window. The second group was founded at some point within the study period and survived until the end of it; after this their status is unknown (left censored). The third group started and finished their activity within the exact time window of the study (Hosmer, Lemeshow, & May, 2011).

The first mathematical function used to analyze the impact of political stability on subsidiary survival is the survivor function, which represents the probability of the event happening the event after time t, this function:

$$S(t)= 1- F(t,\beta,xj) = P(T \geq t)$$ Equation 1: Survivor Function (Cleves, Gould, & Marchenko, 2010; Hosmer et al., 2011)

Where F(t) represents the cumulative distribution function and consists of (t,β,x), t refers to the actual observed time, and β refers to distribution variables that need to be estimated, which can be zero or one. When β is equal to one it shows the probability that the expected event happens for a subject at time t, and x represents the value of the covariate of interest (Hosmer et al., 2011).

Another crucial function in survival analysis is the hazard function, which models the time until a subject experiences the event. It models risk as the accumulation of risk over time (George, Seals, & Aban, 2014). The hazard function with a value of zero means there is no risk for the subject to infinity. The hazard function that is a function of time is defined as equation 2:

$$h(t)= \lim_{\Delta t \to 0} \frac{(P(t<x\leq t+\Delta t)|x>t)}{\Delta t} = \frac{f(t)}{S(t)}$$ Equation 2: Hazard Function (Cleves et al., 2010)

The numerator is the probability of an event (x) happening at a particular time interval. The reason for conditioning this range $x > t$ is that the subject is still under observation when the study begins (Cleves et al., 2010).

The parametric survival model with mixed effects is used for analyzing the survival rate in this thesis. This model considers the multiplicative effects of the independent variable on the hazard function:

$$\boldsymbol{h(t|x) = h_0(t)\exp(x_j \beta_x)}$$ Equation 3: Parametric Proportional Hazard (Cleves et al., 2010)

The main assumption in the parametric survival model is predicting the shape of the hazard baseline ($h_0(t)$). Different distribution models are used for specifying the hazard function. However, as each distribution model leads to the loss of some information per observation, Akaike information criterion (AIC) is used to try to measure the missed information. As a result, the best model the best model will have the least amount of lost information (Wang, Kalpathy-Cramer, Kim, Fuller, & Thomas, 2010). Since the Weibull distribution model has the lowest value of AIC, it was used for this thesis. The equation 4 provides the baseline hazard function:

$$\boldsymbol{h_0(t) = pt^{p-1}\exp(\alpha)}$$ Equation 4:Weibull Distribution Baseline Hazard (Cleves et al., 2010)

To estimate the baseline hazard, this model was fit to the parameters (α,p,β_x^'), that is the hazard ratio of the coefficients of the ith covariate, with the shape of the baseline represented by represented by p as one ancillary parameter and α as the second ancillary parameter to estimate the baseline hazard (Cleves et al., 2010).

The term mixed effects is used when the model includes random and fixed effects (Crowther, Look, & Riley, 2014). In order to analyze multiple random effects in a specific cluster, the mixed effects parametric survival analysis model is used. This model is formulated as the model 5.3.5, in which u_j represents the cluster j (cluster refers to a group of individuals that share the same characteristics) and z_{ji} represents the covariates that are related to the random effect (Austin, 2017). Mixed effects were selected because the moderators reported in the TK dataset are at the subsidiary level, while the independent variable (political stability) and control variables are at the country level. In order to account for the differing levels of analysis and the unobserved heterogeneity among subsidiaries, a mixed effect model was selected, and the cluster for this model was based on the ID of subsidiaries that is shown the country they entered. Stata 15 was used to analyze the models.

$$\boldsymbol{h(t_{ij}) = h_0(t_{ij}) \exp(x_{ij}\,\beta + z_{ji}u_j)}$$ Equation 5: Multilevel Mixed Effects Parametric Survival Model

5.4 Sample Characteristics

Figure 3 shows the frequency of subsidiaries established each year in a primary industry during 1914–2013. As the figure shows, the number of investments in the primary sector between 1914 and 1955 was not considerable until 1960, when the number of investments dramatically increased. After a sharp decline in 1965, the number of investments continued to increase until 1980 and again sharply declined until 1990, which saw the largest number of investments; after that, until 2013, the number of investments showed a decreasing trend.

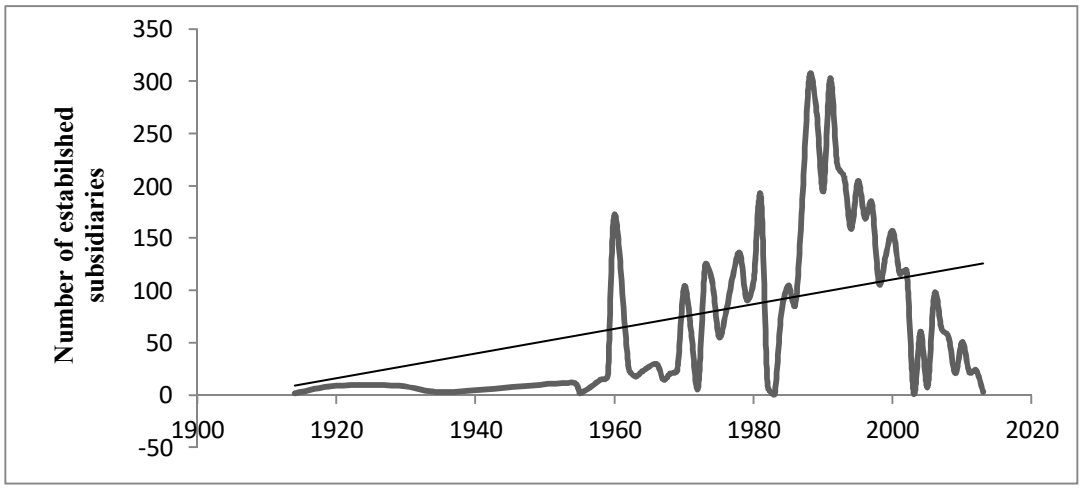

Figure 3: Number of subsidiaries established

Figure 4 shows the frequency of the various motives between different subsidiaries. Natural resources seeking is the most common motive among subsidiaries, followed by efficiency seeking and strategic asset seeking. Market seeking is the least common motive among subsidiaries.

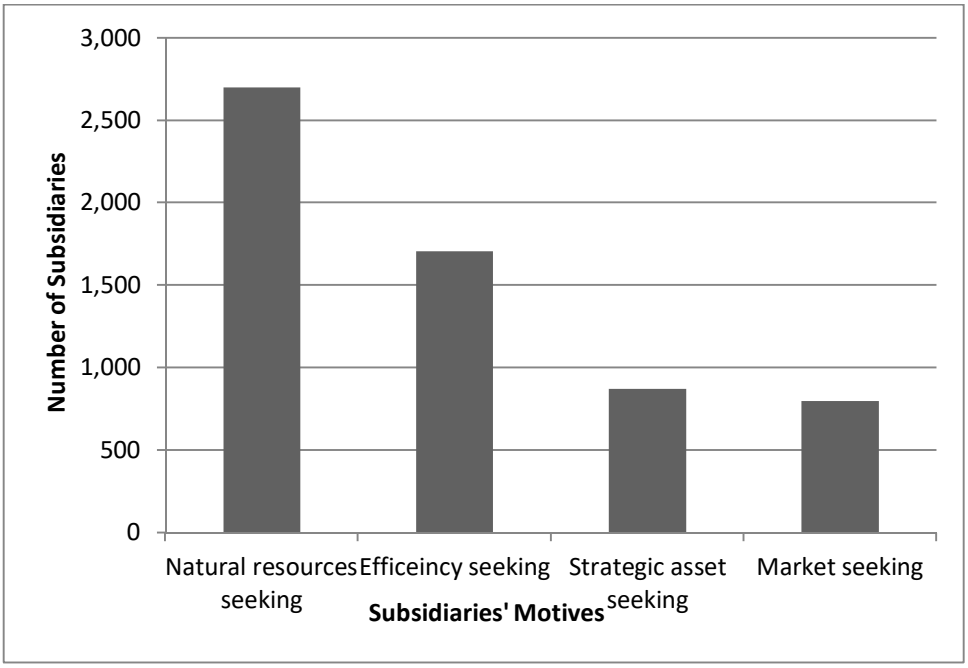

Figure 4: Subsidiaries' motives

CHAPTER 6: RESULTS

6.1 Assumption of Proportional Hazard Model

In order to use the proportional hazard model, the assumption of the proportionality should be checked. Proportionality shows that the hazard baseline is constant and that the covariates do not change over time. To check this assumption, the Schoenfeld residuals test was applied. Since the null hypothesis of the Schoenfeld residuals test is that the hazard rate is constant over time, the non-significant test (p=0.27, Table 7) shows the null hypothesis will not be rejected, suggesting that the proportionality assumption requirements are met. Figure 5 represents the effect of time on each independent variable. The approximate zero slope supports the validity of the proportionality assumption.

Table 7
Test of Proportional Hazard Assumption

Variables	rho	chi2	df	Prob>chi2
Country risk	0.05783	1.21	1	0.2721
Global test		1.21	1	**0.2721**

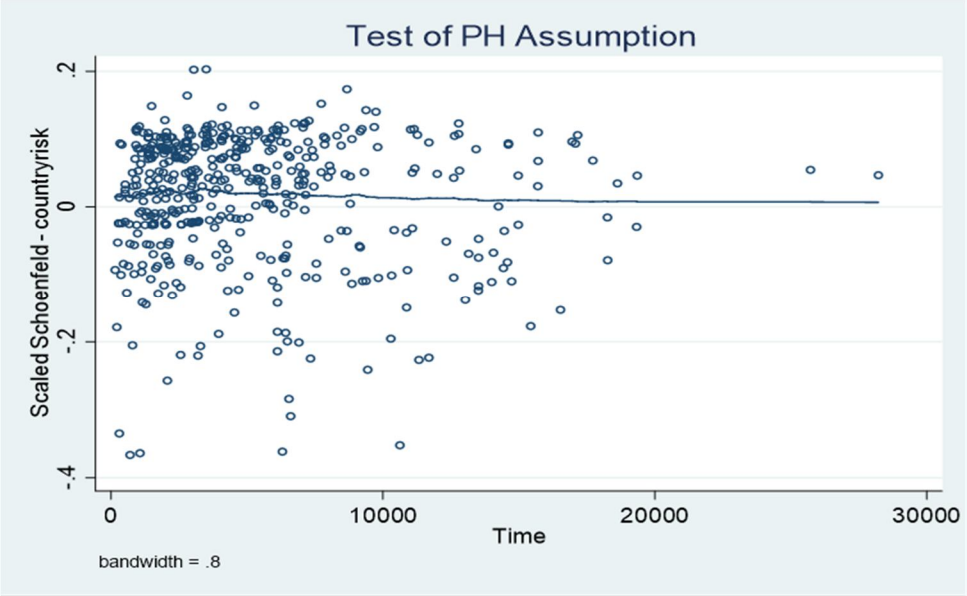

Figure 5: Test of proportional hazard for country risk

6.2 Results of Hypothesis Testing

Table 8 shows the summary of sample statistics and the correlation between variables.

Table 8
Correlation between Variables

Variables	1	2	3	4	5	6	7	8	9
1.CountryrRisk									
2.Market seeking	-0.1366								
3.Natural resource seeking	-0.0646	0.0323							
4.Strategic asset seeking	0.0055	0.127	0.2422						
5.Efficiency seeking	-0.2296	0.4208	0.3075	0.182					
6.FDI inflows	0.1501	-0.0473	-0.1289	-0.0264	-0.1172				
7.Trade ratio	0.0869	-0.0389	-0.1523	-0.0285	-0.0523	0.4637			
8.Population	0.1183	-0.0317	-0.1335	-0.0518	-0.0651	0.3131	0.7614		
9.GDP per capita	0.5585	-0.1820	-0.1271	-0.0450	-0.2505	0.1945	0.0171	0.1006	
10.GDP growth	0.017	-0.012	-0.0284	-0.0129	-0.0194	-0.0079	0.0227	-0.0015	-0.016

Table 9 represents the results of running mixed effect parametric models. This table contains seven models. Model 1 includes the control variables. The linear term and quadratic term of country risk were added in Model 2 and Model 3, respectively. Models 4 to 7 include the interaction terms. The Wald test chi squared represents how the fit of the models changes with adding different covariates. The null hypothesis of the Wald test is that adding a variable to the model does not add any value to it and removing it from the model does not impact the fit of the model. As shown in Table 9, the chi squared of all models is significant, meaning that the Wald test is different than zero, and adding those variable in the model is statistically significant. The log likelihood performs a similar function to the Wald test, i.e. it allows one to asses a model's fit. The difference from the Wald test is that log likelihood needs two models for comparison.

Table 9
Result of Mixed Effect Models on Subsidiary's Survival

Variables	Model 1	Model 2	Model 3	Model 4	Model 5	Model 6	Model 7
FDI inflow	0.025*	0.023**	0.021**	0.018*	0.02*	0.021**	0.02
	(0.009)	(0.008)	(-0.008)	(0.008)	(0.008)	0.009	0.008
Trade ratio	-0.001	-0.002	-0.001	-0.001	-0.001	-0.001	-0.001
	(0.002)	(-0.002)	(-0.002)	(0.002)	(0.002)	0.002	0.002
Population	0.001*	0.001 ŧ	0.001*	0.001*	0.001*	0.001	0.001*
	(0.001)	(-0.001)	(-0.001)	(0.001)	(0.001)	0.001	0.001
GDP per capita	0.00	0.00	0.00	0.00	0.00	0.00	0.00
	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	0.00	0.00
GDP growth	-0.001	-0.001	-0.001	-0.001	-0.001	-0.001	-0.001
	(0.001)	(-0.001)	(-0.001)	(0.001)	(0.001)	0.001	0.001
Country risk		0.045**	0.527**	0.589**	0.432**	0.612**	0.525**
		(-0.012)	(-0.112)	(0.152)	(0.116)	0.123	0.116
Country risk^2			-0.004**	-0.005**	-0.003**	-0.005**	-0.004**
			(-0.001)	(0.002)	(0.001)	0.001	0.001
Natural resource seeking				5.175			
				(7.611)			
Natural resources seeking × country risk				-0.215			
				(0.216)			
Natural resources seeking × country risk^2				0.002			
				(0.002)			
Efficiency seeking					-25.033		
					(12.43)		
Efficiency seeking × country risk					0.672*		
					(0.345)		
Efficiency seeking × country risk^2					-0.005*		
					(0.003)		
Market seeking						20.649	
						(10.69)	
Market seeking × country risk						-0.555 ŧ	
						(0.309)	
Market seeking × country risk^2						0.004	
						(0.003)	
Strategic asset seeking							-6.391
							(15.432)
Strategic asset seeking × country risk							0.149
							(0.428)
Strategic asset seeking × country risk^2							-0.001
							(0.003)
Constant	-30.196**	-31.447**	-45.933**	-47.725**	-41.136**	-49.239	-45.772
	(4.001)	(3.223)	(5.152)	(6.405)	(5.086)	(5.622)	(5.26)
Number of observations	5,610	5,603	5,603	5,603	5,603	5,603	5,603
Log likelihood (LL)	-4678.183	-4661.174	-4652.204	-4642.531	-4648.891	-4648.486	-4649.124
Wald chi2	16.12	31.07	39.84	62.75	42.86	46.34	47.71
Prob > chi^2	0.0065	0.00	0.00	0.00	0.00	0.00	0.00

ŧ p <0.10, * p<0.05, ** p<0.01
Standard deviation of coefficients is in parentheses.

Hypothesis 1 concerned the relationship between political stability and subsidiary survival. It was argued that this relationship has a curvilinear shape and that subsidiary survival rate is influenced by the level of political stability—where lower and higher levels of stability lead to greater chances of survival in foreign countries. To analyze Hypothesis 1, Model 2 and Model 3 in Table 9 were used. Model 2 contains the linear term of the country risk (as a measure of political stability) and control variables. As the coefficient shows the hazard rate, the significant ($p < 0.001$) and positive coefficient shows that a one-unit increase in the country risk level leads to a 4% increase in exit hazard. Since Hypothesis 1 proposed that political stability has a curvilinear relationship with subsidiary survival, to test this hypothesis the squared term of country risk was added in Model 3. This significant model ($P<0.001$) suggests that the effect of country risk on subsidiary survival is not a linear relationship. Adding the quadratic term (country risk^2) to the model shows the effect of country risk on the exit rate, which decreases the exit rate when subsidiaries experience a higher level of risk. The negative coefficient of the quadratic term estimates an increase and then a decrease in the hazard rate (inverted u). When the country risk is at the lowest level (30), the exit hazard increases by 52%. For each additional unit of country risk (measured on a 100-point scale), the negative coefficient of the squared term shows that the relationship with survival is u-shaped (i.e. the opposite of the exit hazard).

Hypothesis 2a concerned the moderating effect of natural resources-seeking motives on the relationship between political stability and subsidiary survival. The argument was that this investment motive leads to an increase in the survival rate of a

subsidiary. The interaction term between country risk and natural resources seeking was added to Model 4 to test this hypothesis. The p-value of *country risk × natural resource seeking* and *squared country risk × natural resource seeking* (p =0.32, p=0.253, respectively) indicates that natural resource seeking has no moderating effect on the relationship between political stability and subsidiary survival. Therefore, Hypothesis 2a is not supported.

Hypothesis 2b concerned the moderating effect of efficiency-seeking motives on the relationship between political stability and subsidiary survival. The argument was that firms with this investment motive will survive longer in the host country. to test this hypothesis, the interaction term was added to the main model. The coefficients for the interaction terms *country risk x efficiency seeking* and *country risk^2 x efficiency seeking* in Model 4 are marginally significant (p = 0.051. p = 0.056). This offers qualified support for Hypothesis 2b, that having efficiency-seeking motives improves subsidiary survival in politically unstable countries. Also, this relationship can be explained by checking the changes in the coefficients of country risk and country risk squared. The coefficient of country risk in comparison to Model 3 (without interaction) shows a 10% reduction in exit rate (a change from 52% to 43%), and the squared term shows a reduction of about 0.1% (a change from −0.4% to −0.3%). This supports the argument that having an efficiency-seeking motive reduces the chance of exit when political instability increases, although the effect is fairly small.

Hypothesis 2c concerned the moderating effect of market-seeking motives on the relationship between political stability and subsidiary survival. The argument was that the relationship between political stability and subsidiary survival is weaker for firms with a

market-seeking investment motive. Model 6 includes the interaction term between country risk and political stability. The p-value of *country risk x market seeking and country risk*^{2} *x market seeking* is marginally significant (p =0.072, p=0.108). This significant interaction supports Hypothesis 6, that having market-seeking motives reduces subsidiary survival when the level of political instability increases. To make the interpretation of this interaction easier, predictive margins were used. According to Figure 8, when firms do not have a market-seeking motive, an increase in country risk leads to a decrease in the hazard rate. With changes in the linear and squared term coefficients of country risk, the effect is more tangible. As the coefficient of country risk increases by about 10%, this means that this investment motive increases the chance of exit, and an additional increase in the country risk leads to a 0.1% increase in the exit hazard compared to Model 3, where no interaction term was added.

Hypothesis 2d concerned the moderating effect of strategic-asset-seeking motives on the relationship between political stability and subsidiary survival. The argument was that the curvilinear relationship between political stability and subsidiary survival is weaker for firms with a strategic-asset-seeking motive. To test this hypothesis, the interaction terms *country risk x strategic-asset seeking and country risk*^{2} *x strategic-asset seeking* were added in Model 7. The p-value of these interactions is not significant (p = 0.728, p = 0.737); therefore, Hypothesis 2d is not supported.

To control for some economic effects that might have impacted the results, I added GDP per capita, GDP growth, FDI net inflows, and population to my models. Model 1 is specified for control variables that were drawn from the World Bank's website. According to this model, FDI net inflow (as measured by all types of

investment—short-term and long-term in different countries than the investors) and population (measured by the number of citizens) were statistically significant (P=0.003, p=0.027, respectively).

CHAPTER 7: DISCUSSION

7.1 Discussion of Hypotheses

7.1.1 Political Stability and Subsidiary Survival

As was expected, a high level of political stability reduces the exit hazard, although with diminishing returns, as indicated by the u-shaped relationship. Reliable rules and procedures from the government provide safeguards that MNEs' technology and intellectual property are likely to be supported, and that investors can rely on contract terms. Also, stable policies provide a trustworthy environment in which expropriation will be less of a hazard to the survival of firms in the host country.

On the contrary, when the government does not provide stringent requirements for investment, investors also have greater negotiation power to shape the policy to their own interests, and negotiation in this situation will be more applicable than when there is a higher level of stability. However, the role of stakeholders in this environment will be more impactful, as their presence can provide tax sheltering for investors. In the extreme case, corruption and bribery can impact this relationship, as previous studies show that a high level of corruption can help firms to interpret and use regulations based on what they need in the host country (Egger & Winner, 2005; Kolstad & Wiig, 2013; Petrou & Thanos, 2014).

7.1.2 Natural Resource-Seeking Investments

According to Figure 4, the most reported motive by Japanese firms is the natural resources-seeking motive. As the focus of this study is the primary industries sector, most of the firms in this sector are assumed to have the fundamental purpose of finding cheaper

and/or more accessible resources. Moreover, each investment has some requirements that make competitors distinctive from each other. For example, having sophisticated technology or knowledgeable employees are considered as firms' capital. These advantages give them the power to negotiate with the government, use concessions, and award contracts, or allow them to gain the support of interest groups to stay permanently in the host country. As mentioned earlier, domestic firms in many resource-rich countries in the primary sectors do not initially have the technological ability to extract their resources efficiently. The results provided no evidence that survival is influenced by this motive, which may simply be because firms failed to report it as a primary motive, since it can be assumed in the primary sectors.

7.1.3 Efficiency-Seeking Investments

As mentioned earlier, the main purpose of the efficiency-seeking motive is that firms are looking to reduce their costs through investment in the host country. In the TK dataset, managers reported that they are looking to reverse import resources to Japan, reduce labor costs, and/or create a reliable network for the export of extracted resources. When host countries do not have reliable infrastructures to meet these expectations, they also need foreign firms to invest. If the political environment is not a stable in the investment country, it provides an opportunity for MNEs to change or avoid regulations based on what is more beneficial for them, while they improve infrastructure based on local needs. Also, as the cost of transportation is one of the fundamental costs that investors must tackle, high political instability helps them to reduce transportation costs using bribes and/or paying cash in transactions. Since the aim of efficiency-seeking

investments is to produce in low-cost countries and sell in high-cost countries, this instability helps them to decrease their costs and increase their benefits.

7.1.4 Market-Seeking Investments

The priority of the market-seeking motive is finding or developing a market that makes accessing suppliers and distributors easier, while achieving gains from scale. The lack of a developed market is a typical problem in countries with lower levels of political stability, as it reduces the attractiveness of the market. Since one important characteristic of a developed market is that relationships between individuals and groups are based on hard trust, that is, predefined rules and procedures, markets within countries with lower levels of political stability tend to be less efficient, which in turns makes transactions more expensive. The reason for is that in an unstable political environment, individuals create groups based on their own benefits, and entrance to these groups is a challenge for foreign investors. MNEs need to find the influencers of those groups and then try to become familiar with their market structures, which is both expensive and time consuming.

7.1.5 Strategic-Asset-Seeking Investment

The range of factors considered to be components of the strategic-asset-seeking motives are broad—preferential treatment by the government, strengthening the function of headquarters, knowledge seeking, and so forth. Each of these factors could be differently influenced by political instability. However, the motives reported by TK that are related to the strategic-asset seeking motive emphasize the knowledge-seeking aspect. Specifically, these include knowledge sharing, the R&D potential of the host country, and

the readiness of the host country for creating new business. Since the focus of this thesis is on the primary sector, including various industries such as farming, mining, fishing, and forestry, the inconsistent results with the hypothesis may be due to differences in the industries. Specifically, the type of knowledge sought may be more or less influenced by government policy, depending on the industry.

7.2 Conclusion

This thesis sought to investigate some of the neglected characteristics of the primary industries. To do so, the impact of political stability on subsidiary survival, with the potential moderating effect of investment motives, was studied in the context of Japanese FDI. The results of a mixed effect parametric model shows that political risk has a u-shaped relationship with subsidiary survival, such that both high and low stability were associated with higher survival (lower exit hazard), while moderate levels of risk reduced subsidiary survival. This nonlinear relationship was shown to be stronger with the efficiency-seeking motive and weaker with the market-seeking motive, as expected.

Most of the previous studies consider the attractiveness of a location based on revealed investment location preferences, whereas survival is based on investment outcomes. Moreover, survival is considered a hazard, so I knew that whether subsidiaries could survive or not but influential factors on their survival was the topic of interest in this thesis. Also, in order to discover differences between the impacts of different investment motives, I hypothesized motives as moderators. Another benefit of this study is that it relies on the stated motives of MNE representatives, rather than on inferences based on the industry.

This study examined the impact of political risk on subsidiary survival. Since survival is considered a factor for performance assessment, it will help managers to think about how different levels of political uncertainty in the host country impact the firm's performance. Also, it will demonstrate that there are potential advantages to political instability, as it can create the opportunity to construct a more favorable investment environment.

7.3 Limitation and Future Research

Since the dataset is constrained to Japanese firms, the generalizability is limited beyond this sample. Moreover, since multiple observations per firm were reported, firms fixed effect was used, but I did not model the industry fixed effects due to time invariant measures at that level, and so the impact of industry on the result is unknown. As the primary sector includes various industries, such as fishing, mining, and forestry, it is possible that the relationship between political stability and subsidiary survival changes depending on the specific industry. Future researchers may wish to consider the moderating impact of different investment types on the relationship between political stability and subsidiary survival, as investment type is one of the main considerations for investment. The impact on survival of similarities in the political environment between the host and home countries is another possible area for future research; this would require a sample of investment firms from multiple countries.

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