



Institutional origins of WOFS formal contracting: A judicial arbitrariness perspective



George O. White III^{a,*}, Thomas Hemphill^a, Thomas Weber^b, Kaveh Moghaddam^c

^a School of Management, University of Michigan-Flint, 2104 Riverfront, Flint, MI, 48502, USA

^b Romain College of Business – BEC 2089, University of Southern Indiana, 8600 University Boulevard, Evansville, IN 47712, USA

^c School of Business, University of Houston-Victoria, 14000 University Blvd, Sugar Land, TX 77479, USA

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ABSTRACT

In drawing from neo-institutional theory and the institution-based view, this study provides new insights concerning how home and host country norms influence wholly owned foreign subsidiary (WOFS) formal contract utilization. Our analysis of 171 WOFSs operating in the Philippines suggests that parent home country uncertainty avoidance, as an institutionalized organizational practice, is positively related to WOFS utilization of formal contracts in governing interorganizational relationships. Our results also reveal that managerial perceptions of local judicial arbitrariness directly influence formal contract utilization, and moderate the positive relationship between parent home country uncertainty avoidance and WOFS formal contract utilization. Furthermore, when compared to managerial perceptions of national judicial arbitrariness, perceived local judicial arbitrariness will exhibit a stronger negative direct and indirect influence on WOFS formal contract utilization. Implications and future research directions are discussed.

1. Introduction

Doing business abroad is deemed a risky proposition for multinational enterprises (MNEs) (e.g., Brouthers, Brouthers, & Werner, 2000), especially in emerging market environments (Hoskisson, Eden, Lau, & Wright, 2000). Nonetheless, globalization has spurred increased investment by MNEs in emerging markets, often taking the form of wholly owned foreign subsidiaries (WOFSs) which are often established in order to protect valuable proprietary resources via structural integration (via complete ownership and management control) (Keupp, Beckenbauer, & Gassmann, 2010; Li, Yang, & Yue, 2007). Due to this structural integration, an important advantage WOFSs possess over other modes of foreign market entry is that they typically have greater control over their operations and assets (such as intellectual property, including product and process related trade secrets) (Brouthers, 2002; Feinberg & Gupta 2009; Luo, 2001). Because they possess both equity and operational control, WOFSs will be particularly inclined to look for ways of mitigating external exchange hazards associated with interorganizational relationships in their value chain partners (i.e., with suppliers, buyers, banks, local affiliates) (hereinafter interorganizational relationships) through the utilization of formal contractual arrangements.

However, consider the possible tension that may exist concerning

the transference of MNE parent (hereinafter “parent”) organizational practices influencing commercial contract utilization and WOFS managerial perceptions of a judicial system’s partiality (i.e., arbitrariness) when ruling on (and enforcing) laws established to govern contractual arrangements in a host country. For example, Apple has been heavily involved with legal actions in numerous host countries against organizations associated with its value chain. These legal actions have followed parent organizational practices, based largely on institutional norms established in its home country, to purposefully use courts in resolving contractual issues against partners causing external exchange hazards (Casarin, 2015). In general, Apple’s strategic behavior in judicial arenas has afforded the organization competitive advantages even where judges in many of these jurisdictions have “well-defined preferences” adjudicating a case grounded on “the basis of personal rewards, which may include bribes, and under conditions of threats and intimidation” (Casarin, 2015: 141).

Past research has explored host country and firm-level determinants of contract utilization in international joint ventures (e.g., Luo, 2005) and buyer-supplier relationships (Zhou & Poppo, 2010) in emerging markets. Although, to date, the international business literature has yet to investigate how the transference of strategic practices influenced by norms established in the parent’s home country, and managerial perceptions of a host country’s judicial system, will affect WOFS formal

* Corresponding author.

E-mail addresses: gowhite@umflint.edu (G.O. White), thomashe@umflint.edu (T. Hemphill), thomas.weber@usi.edu (T. Weber), K@UHV.edu (K. Moghaddam).

contract utilization in its value chain. This is an important theoretical and empirical gap in the literature, considering that emerging markets often consist of substantial appropriation risks (Oxley, 1999), as well as institutional uncertainty (Luo, 2007) and voids (Doh, Rodrigues, Saka-Helmhout, & Makhija, 2017), that can often counteract the competitive advantages associated with governing interorganizational relationships through formal contracting.

Our efforts are focused on addressing these important gaps in the international business literature. Therefore, we suggest that not all WOFSSs will utilize formal contracts to the same extent in governing interorganizational relationships in an emerging market environment. We propose that, while influenced by host country institutional factors that are tied to managerial perceptions of judicial arbitrariness in enforcing court decisions, variation in WOFSS utilization of formal contracts as value chain governance mechanisms may also be shaped by organizational practices stemming from parent home country norms (cf. Kriauciunas & Kale, 2006; Roth & Kostova, 2003). Specifically, drawing from neo-institutional theory (Kostova & Zaheer, 1999; North, 1990), we consider that a WOFSS's propensity to utilize formal contracts in governing interorganizational relationships will be influenced by current institutional norms within its *home* country (Rosenzweig & Singh, 1991). These home country norms can lead to institutionalized strategic practices within the MNE that are transferred to foreign subsidiaries (Gamble, 2010; Kostova, 1999; Kostova et al., 2008). This theoretical proposition is based on the notion that the legitimacy of a WOFSS's operations in a foreign market will be contingent on the continued support of the parent firm's approval of strategic behavior in a host country (Hillman & Wan, 2005).

Yet, at the same time, strategic decisions are often determined by senior manager perceptions of legal institutions and the subsequent influence of these legal institutions on their strategic choices in managing the daily operations of the WOFSS (cf. Luo, 2007; Peng, 2002; Roy, 2012). Thus, we also apply the institution-based view (IBV) (Peng, 2002; Pinkham & Peng, 2017; White, Boddeyn, & Galang, 2016) when considering that host country institutions can influence the extent to which foreign subsidiary managers strategically utilize formal contracting practices when governing interorganizational relationships. Furthermore, in recognizing the tension that home and host country institutional factors have on the extent of WOFSS formal contracting, we ask the following research question: how will uncertainty avoidance and the rule of law in a parent's home country, as opposed to managerial perceptions of national and local judicial arbitrariness in a host country, influence the extent of a WOFSS's formal contract utilization in governing interorganizational relationships?

Focusing on this key research question, we seek to extend the current state of the international business literature by synthesizing neo-institutional theory (Kostova & Zaheer, 1999; Kostova, 1999; North, 1990; White et al., 2015) with the IBV (Meyer, Estrin, Bhaumik, & Peng, 2009; Oliver, 1997; Peng, 2002; Peng, Wang, & Jiang, 2008) to help us explain how the tension between home and host country institutional factors influence the heterogeneity of a WOFSS's formal contract utilization in governing interorganizational relationships. Specifically, we argue that the level of uncertainty avoidance and rule of law in a WOFSS's home country, which we characterize as home country institutional norms that are reflected in the transference of internalized strategic practices by the parent (Ahlvik & Bjorkman, 2015; Makino, Isobe, & Chan, 2004), will positively influence a WOFSS's propensity to utilize formal contracts governing host country interorganizational relationships with partners in its value chain.

We further argue that the variation in managerial perceptions of host country judicial arbitrariness, meaning that the “enforcement [of laws] will often be erratic and partial in legal systems that lack uniform and transparent governance standards set by judicial officials” (White et al., 2015: 345), will diminish the positive relationship between the transference of internalized strategic practices influenced by home country norms (i.e., uncertainty avoidance and the rule of law) on the

WOFSS' strategic utilization of formal contracts as governance mechanisms. Further, in recognizing the importance of disaggregating judicial court decisions at the national (i.e., federal) and local (i.e., city or provincial) levels, we compare how the effects of managerial perceptions of host country judicial arbitrariness directly and indirectly influence these contractual relationships.

We test our proposed hypotheses by employing unique survey data from the Philippines with other sources of archival data, including data derived from the GLOBE study (House, Hanges, Javidan, Dorfman, & Gupta, 2004). We contribute to the literature in at least three ways. First, we employ neo-institutional theory and the IBV in theoretically exploring how the interaction between home and host country institutional factors affects WOFSS strategic utilization of formal contracts as governance mechanisms in interorganizational relationships within its value chain. Past research has largely focused on how *host* country institutions (e.g., Gong, Shenkar, Luo, and Nyaw, 2007; Luo & Shenkar, 2002; Luo, 1999, 2002, 2005), rather than *home* country institutional norms, drive heterogeneity in managerial decision making with regard to the extent of foreign subsidiary utilization of formal contracts. Hence, we theoretically explicate how the interaction between parent home country institutions, reflected in internalized strategic practices within the MNE, and host country institutions drive heterogeneity in foreign subsidiary formal contract utilization.

Second, our findings extend the institutions and parent-subsidiary literature by suggesting that the transference of MNE strategic practices, influenced by parent home country uncertainty avoidance (i.e., informal institutions), but not necessarily home country rule of law (i.e., formal institutions), directly influences a WOFSS's propensity to utilize formal contracts in governing interorganizational relationships. We also find that managerial perceptions of local judicial arbitrariness (at the city and provincial levels), but not national judicial arbitrariness (at the federal level), directly and indirectly influence a WOFSS's proclivity in utilizing formal contracts within its value chain.

Third, the literature has largely ignored foreign subsidiary formal contracting practices in Southeast Asian emerging markets; past research on formal contracting has predominantly focused on China as the context of analysis (e.g., Gong et al., 2007; Li, Poppo, & Zhou, 2010; Luo, 2002, 2005). Thus, we set out to empirically extend the contextual scope of inquiry by exploring institutional drivers of formal contracting practices concerning 171 WOFSSs operating in the Philippines. Fig. 1 depicts the theoretical framework of our study.

1.1. Literature review

A formal contract is created between business entities when three conditions are met. First, there is a written document with an offer identifying the parties involved, describing the subject matter of the contract, and detailing the time of performance and price. Second, consideration has been given for an exchange of legal value. Third, clearly expressed acceptance of specified terms has taken place (Ben-Shahar, 2004; Folsom, Gordon, & Spanogle, 2002). Consequently, a

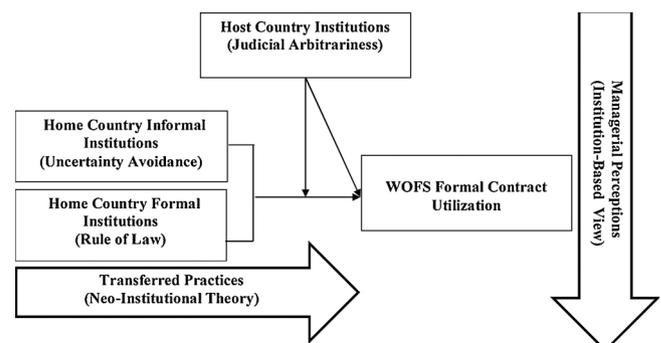


Fig. 1. Theoretical Framework.

formal contract sets out a binding framework with an established “mutually agreed upon set of behaviors or activities and sanctions for non-compliance” (Zhou & Poppo, 2010: 864; see also Shavell, 1984).

Formal contracting mechanisms have been acknowledged as primary governance instruments for foreign subsidiaries facilitating business activities in foreign markets (Luo, 1999, 2002; Shavell, 1984). For example, Gong et al. (2007), Luo (1999, 2002, 2005), and Luo and Shenkar (2002) find that formal contracts will create greater cooperation in international joint venture operations. Similarly, Oxley (1999), Reuer and Arino (2002), and Reuer, Zollo, and Singh (2002) suggest that properly formulated contract governance mechanisms will, in general, mitigate opportunism and protect vital resources in inter-firm alliances, thereby stabilizing and lengthening the venture’s life-span and minimizing risk (Luo, 2005; Poppo & Zenger, 2002). Kogut (1986) further explains that contractual choice, formation, and terms affect risk allocation pertaining to business dealings in countries with inadequate institutional structures (see Hoskisson et al., 2000).

Nevertheless, inadequate enforcement of laws in a society will create uncertainty surrounding the effectiveness of commercial relationships codified in and governed by formal contracts (Pinkham & Peng, 2017; Roy & Oliver, 2009). For example, Zhou and Poppo (2010) find a direct relationship between manager perceptions of legal enforceability, as a potential exchange hazard, and the utilization of formal contracts as governance mechanisms by manufacturing firms operating in China. Other studies have suggested similar patterns of strategic behavior by managers of firms (e.g., Li et al., 2010; Poppo & Zenger, 2002). Lastly, White, Joplin, and Salama (2007) and Yu (2002) argue that formal contracts are classic defensive mechanisms protecting against exchange hazards, but institutional differences between foreign venture home and host country contexts can cause problems in contractual governance.

Notwithstanding this body of literature, empirical research has yet to fully establish which institutional antecedents influence the extent of WOFs formal contract utilization as a governance mechanism in a host country environment. Previous empirical studies have often highlighted the role of host country normative conditions as drivers of foreign subsidiary strategic practices (e.g., Roy & Oliver, 2009; Zhou & Poppo, 2010). Yet, Gamble (2010: 722) found that “both country of origin and host country practices [are] likely to be found in MNCs overseas subsidiaries.” Yet, little is known about the role of MNE home country normative conditions and their influence on the transference of “institutionalized” practices from the MNE to its foreign subsidiaries. The international business literature has indicated that home country institutions can act as possible drivers of heterogeneity in MNE strategic practices (e.g., White, Hemphill, Joplin, & Marsh, 2014), yet research has not investigated how MNE formal contracting practices are shaped by differences in institutional norms across countries. Subsequently, we attempt to extend the literature by proposing and empirically investigating how specific dimensions of both home and host country norms will influence a foreign subsidiary’s managerial efforts towards utilizing formal contracts as mechanism for governing interorganizational relationships.

2. Theoretical development

2.1. The direct role of home country uncertainty avoidance

Previous research demonstrates that informal institutions, such as cultural norms, in a parent firm’s home country can be “institutionalized” and transferred to host country operating environments—thereby influencing foreign subsidiary strategic behavior (Kostova & Roth, 2002; Kostova, 1999). This premise is based on the understanding that foreign subsidiaries are “considered . . . an integrated part of [their] parent firm in that core resources are transferred from the parent firm [to the subsidiary]” (Makino et al., 2004: 1029). Specifically, neo-institutional theory suggests that foreign subsidiary

organizational practices and routines are partially formed based on the institutions within its parent’s home country; in that a foreign subsidiary will interpret its own operating environment through a lens shaped by the parent’s home country institutional norms (Holburn & Zelner, 2010; Oliver, 1997). Roth and Kostova (2003) find that home country norms are difficult for firms to change and become an integrated part of organizational routines and practices implemented in international operations. Pan (2002) also finds that foreign subsidiaries with parent firms from home countries high in uncertainty avoidance preferred greater structure and control in international joint venture ownership structures; this structure and control was operationalized via higher levels of equity ownership in order to enhance predictability.

Moreover, this line of reasoning tells us that MNEs “typically build their original resource endowments in their home country. . . [where the] MNE’s embeddedness in their home country [institutional] context [] may act as either inducements or constraints [in] overseas business activities. . .” (Meyer, Mudambi, & Narula, 2011: 239). Previous studies have argued that this “dual” embeddedness will subject foreign subsidiaries to institutional pressures shaped by a parent’s home country context (Andersson, Forsgren, & Holm, 2002; Benito, Lunnan, & Tomassen, 2011; Blumentritt & Nigh, 2002; White, Fainshmidt, & Rajwani, 2017). For example, Hillman and Wan (2005: 324) discovered that U.S. based MNE strategies in Western Europe were influenced by “simultaneous pressures for foreign subsidiaries to conform to two different sets of [institutional] . . . pressures” being “both external and internal [in nature which] likely. . . influence[d]. . . foreign subsidiary strategies.” Thus, we argue that the transference of “institutionalized” strategic practices (shaped by a parent firm’s home country cultural norms) will directly influence the extent to which a WOFs will utilize formal contracts to govern interorganizational relationships within its value chain.

The uncertainty avoidance dimension of national culture has been widely considered a key construct in predicting risk taking versus risk avoiding behavior (e.g., Guillen, 2002). Uncertainty avoidance has been traditionally used as a measure explaining how much tolerance a national culture has towards risk (Hofstede, 1980, 2001; Franke, Hofstede & Bond, 1991). According to Hofstede (2001: 148), uncertainty avoidance as “[u]ncertainty-avoiding cultures shun ambiguous situations. People in these cultures look for structure in their organizations, institutions and relationships, which makes events clearly interpretable and predictable.” More recently, the GLOBE project demonstrated that uncertainty avoidance measures “the extent to which members of collectives seek orderliness, consistency, structure, formalized procedures and laws to cover situations in their daily lives” (Sully de Luque & Javidan, 2004: 603; Venaik & Brewer, 2010), including the “reliance on societal norms, rituals and bureaucratic practices to alleviate the unpredictability of future events” (House, Javidan, Hanges, & Dorfman, 2002: 5; Lewellyn & Bao, 2015). Further, Venaik and Brewer (2010: 1296, 1307) argue that uncertainty avoidance represents a society’s “rule orientation” and desire for stronger formal governance controls that “affects international cooperation because of the tendency for high [uncertainty avoidance] societies to avoid ambiguity and uncertainty that exist more in international business transactions. . .” This line of research also emphasizes that firms from national cultures high in uncertainty avoidance tend to prefer written rules and seek ways to add structure and control to their operating environment(s) (Guillen, 2002; Kale & McIntyre, 1991; Sully de Luque & Javidan, 2004). In summary, the extant literature clearly demonstrates that cultures with a high proclivity for uncertainty avoidance desire to establish governance controls through formalized rules that will create structure, thereby facilitating predictability in business relationships.

With the preceding rationale in mind, and in drawing from neo-institutional theory, we argue that uncertainty avoidance will act as a parent home country transference effect that carries over organizationally “institutionalized” norms embedded in practices influencing

WOFs strategic decision-making in host country operations (Meyer et al., 2011). Neo-institutional theory posits that uncertainty avoidance, as a parent home country norm institutionalized in MNE organizational practices (e.g., Kostova, 1999), can influence a WOFs's propensity to utilize formal contracting as a means of governing interorganizational relationships. Accordingly, these "institutionalized" organizational practices will drive WOFs with parents in home countries high in uncertainty avoidance to seek structure and control of interorganizational relationships through contractual safeguards that will mitigate potential exchange hazards within their value chain. Thus:

Hypothesis 1. WOFs with parents originating from home countries high in uncertainty avoidance will more extensively utilize formal contracts in governing interorganizational relationships, *ceteris paribus*.

2.2. The direct role of home country rule of law

We contend that home country rule of law will also act as a norm that can influence a WOFs's propensity to utilize formal contracts in governing interorganizational relationships within their value chain. Van Essen, Engelen, and Carney (2013: 204) posit that "[t]he rule of law is an indicator of judicial integrity and respect for property rights." Also, Cuervo-Cazurra and Genc (2008: 965) argue that the rule of law in a society creates an environment where "fair and predictable rules form the basis for economic . . . interactions. . ." This occurs because firms make strategic choices by responding to the potential enforcement and sanction of laws within the context of a country's institutional environment (Oliver, 1991; Roy & Oliver, 2009).

Neo-institutional theory suggests that foreign subsidiary strategies are continuously influenced by the spillover of organizational practices from their parent (Ahlvik and Bjorkman, 2015; Kostova, 1999; Makino et al., 2004) which also results in foreign subsidiaries interpreting their host country operating environment through a lens shaped by parent home country institutions (Holburn & Zelner, 2010; Pan, 2002). MNEs "typically build . . . resource endowments in [their parent's] home country. . . [where] embeddedness in their home country context[] may act as either inducements or constraints [for] overseas business [practices]. . ." (Meyer et al., 2011: 239). Kostova and Roth (2002: 216) have stated that "there is a within-organization domain that defines a set of pressures to which all units within the organization must conform. . ." Thus, "subunits are often more dependent on the parent company than their local external environments for critical resources. . . [Thus, MNEs] are likely to consciously create and strengthen their intraorganizational field so as to reinforce and disseminate a shared business model" (Kostova, Roth, & Dacin, 2008: 998).

Results of previous studies have found that this dual embeddedness will force foreign subsidiaries to be subjected to institutional pressures derived at least in part from their parent's home country context (Andersson et al., 2002; Benito et al., 2011; Blumentritt & Nigh, 2002). Hillman and Wan (2005: p. 324) discovered this to be the case for MNEs operating in Western Europe where "simultaneous pressures for foreign subsidiaries to conform to two different sets of [institutional] . . . pressures" that were "both external and internal [in nature] likely. . . influence[d]. . . foreign subsidiary strategies." Transfers of "institutionalized" practices by a parent can be encouraged or made mandatory, such as in the enforcement of the U.S. Foreign Corrupt Practices Act (Boddewyn, 1988). A recent example is J. P. Morgan's elimination of a pay-to-play program in its foreign subsidiary operations in China (BBC News, 2016). This program was eliminated by the U.S. parent company after the settlement of a U.S. government lawsuit which challenged the legality of the program.

Therefore, based on the preceding argument, we posit that the rule of law in a parent's home country will carry-over as an institutionalized practice (Kostova, 1999; Shinkle & Kriacunas, 2012) and directly

influence the extent to which a WOFs strategically utilizes formal contracts in governing interorganizational relationships in a host country (Holburn & Zelner, 2010). Neo-institutional theory strongly suggests that such institutionalized practices will have a direct influence on a WOFs's formal contracting practices – even though the WOFs may attempt to strategically adapt contracting practices based on the ability of the host country legal system to enforce and resolve disputes (cf., Henisz, 2000). As such, organizational practices of WOFs with parents originating from home countries with a stronger rule of law will exhibit a greater propensity to strategically utilize formal contracts as safeguards to protect vital resources and to govern against potential exchange hazards associated with interorganizational relationships within their value chain. Hence:

Hypothesis 2. WOFs with parents originating from home countries high in the rule of law will more extensively utilize formal contracts in governing interorganizational relationships, *ceteris paribus*.

2.3. The direct and indirect role of host country perceived judicial arbitrariness

The IBV view builds on the notion that institutions are regarded as the "rules of the game" in a society (Peng, 2002; cf. Scott, 1995). This includes defining what is "...legally appropriate in institutional settings, and [that] consequently affect perceptions" and strategic behavior of foreign subsidiaries (Roy, 2012: 3). Moreover, "... organizations conform to social expectations because they are rewarded for doing so through increased legitimacy, resources and survival capabilities. . ." (Scott, 1987: 498). Thus, the IBV "... advocates that institutional frameworks signal to managers of WOFs which strategic decisions are suitable" and rationale "in order to mitigate adverse effects associated with formal institutions. . ." (White et al., 2015: 343). Recent studies consider formal institutions to have a "direct" influence on a foreign subsidiary's strategic decision making (e.g., Meyer et al., 2009; Peng, Sun, Pinkham, & Chen, 2009), especially in an emerging market context (Khouri & Peng, 2011; Peng et al., 2008). Hence, the IBV suggests that a subsidiary's strategic choices will be within a framework of rules that threaten sanctions through enforcement in the institutional environment where it operates (Oliver, 1997; Peng et al., 2008; Peng, 2002; Roy & Oliver, 2009).

Judicial systems (courts, tribunals, and government legal departments) provide important institutional support by adjudicating and enforcing laws at both the national and local levels that apply to formalized contractual governance arrangements. With this notion in mind, Luo (2007: 44) argues that "people" (i.e., judicial actors), rather than laws, "play a significant role in shaping commercial activities" in emerging markets (see also White et al., 2014). This is because managers of WOFs, and the firms that they contract with, respond to what they perceive to be "real-world gaps" provided by inefficient and "manipulable" judicial systems (Luo, 2007; Roy & Oliver, 2009). For example, managerial perceptions of a strict system of legal adjudication and law enforcement will substitute for inadequate rules because efficient and well-functioning judicial bodies can provide a framework to help fill institutional voids and alleviate uncertainty for organizations (La Porta, Lopez-de-Silanes, Shleifer, & Vishny, 1998; Pinkham & Peng, 2017). This is because an effective judicial system can compensate for other legal system uncertainties (e.g., a lack of adequate laws or legal service structure), providing enforcement mechanisms that will ensure the fulfillment of contractual obligations (Peng & Zhou, 2005; Zhou & Peng, 2010). Managerial perceptions of these judicial safeguards will encourage the utilization of formal contracting as a means of conducting arm's length commercial transactions with partners in a WOFs's value chain.

However, in an emerging market enforcement of contractual obligations can be perceived by managers as erratic and partial due to courts at both the national (federal) and local (city or provincial) levels

lacking uniform and transparent governance standards (Khanna & Palepu, 2000; Peng & Zhou, 2005; Peng et al., 2008; Pinkham & Peng, 2017). These factors will cause inefficiencies in the judicial system that will spill over into the commercial market – hampering efficient arm’s length business transactions as a form of engagement between WOFSS and partners within their value chain (Roy & Oliver, 2009; see generally Wan & Hoskisson, 2003) – particularly when managers perceive there to be unexpected and arbitrary changes in the enforcement of formal contractual exchanges (e.g., Zhou & Poppo, 2010). This judicial arbitrariness will increase transaction costs associated with ineffective enforcement of formalized contractual safeguards that protect against opportunism in complex interorganizational relationships (Luo, 2007; Zhou & Peng, 2010). In essence, the lack of uniform enforcement will stimulate opportunistic behavior by contracting partners (Keupp et al., 2010; Williamson, 1985), rather than “increased confidence in the likelihood of exchange partners’ fulfilling legal obligations” (Zhou & Peng, 2010: 360) due to doubt in the effectiveness of the judicial system (Pinkham & Peng, 2017).

The IBV suggests that managerial perceptions of judicial arbitrariness will substantially differ between WOFSS due to variation in home country institutional backgrounds and strategic motives that will influence interpretation of judicial actions at both the national and local levels in a host country (Kostova & Roth, 2002; Peng, 2002; Roth & Kostova, 2003). For example, managerial perceptions concerning judicial decisions made by national courts arbitrarily enforcing intellectual property rights can negatively influence future decisions by WOFSS in strategically utilizing formal contracts as governance controls against opportunism. This same notion also holds true for managerial perceptions of arbitrary or partial court rulings at the local level (e.g., at municipal or provincial levels of government), leading a WOFSS to rethink the utility of relying on formal contracts to govern value chain relationships. Thus, these perceptions will diminish the transference effects of organizational practices influenced by uncertainty avoidance and the rule of law. Moreover, these perceptions result because the utilization of formal contracts will no longer be viewed as effective governance arrangements if judicial enforcement of interorganizational relationships with value chain partners is perceived by managers as being unfair and discriminatory in nature. In other words, the utilization of formal contracts as a preferred form of governance will no longer be viewed by managers as providing effective structural support for WOFSS with parents originating from home countries high in uncertainty avoidance and rule of law when managerial perceptions of judicial arbitrariness in a host country are also considered high. Therefore:

Hypotheses 3a-b. WOFSS that perceive host country (a) national and (b) local judicial arbitrariness to be high, rather than low, will be less likely to utilize formal contracts in governing interorganizational relationships, *ceteris paribus*.

Hypotheses 4a-b. The positive relationship between high home country uncertainty avoidance and formal contract utilization will be weaker for WOFSS that perceive host country (a) national and (b) local judicial arbitrariness to be high rather than low.

Hypotheses 5a-b. The positive relationship between high home country rule of law and formal contract utilization will be weaker for WOFSS that perceive host country (a) national and (b) local judicial arbitrariness to be high rather than low.

2.4. *The differential influence of perceived national and local judicial arbitrariness*

With the previous hypotheses in mind, we theorize that heightened levels of both national and local perceived judicial arbitrariness will have negative influences on the transference of organizational practices influenced by parent home country uncertainty avoidance and the rule

of law on the utilization of formal contracts by a WOFSS. However, this does not imply that both types of perceived judicial arbitrariness will equally influence how uncertainty avoidance and the rule of law, as institutionalized organizational practices, will impact the extent of WOFSS formal contract utilization. For example, Shi, Sun, and Peng (2012) argue that despite the national implementation and regulation of corporate law in some emerging markets, the influence of sub-national institutions plays a very prominent role in foreign subsidiary managerial strategic decision making (see Meyer & Nguyen, 2005). Further, formal contracting is usually conducted at a local level—with enforcement of laws governing formal contracts typically falling under the jurisdiction of local tribunals (Varady, Barcelo, & von Mehren, 1999). Therefore, when considering the IBV, we argue that while managerial perceptions concerning the arbitrary nature of a national judicial system have implications as to the extent of WOFSS formal contract utilization, perceptions of local judicial arbitrariness will have an even greater impact on the extent that a WOFSS utilizes formal contracts to mitigate exchange hazards within its value chain. We therefore hypothesize the following:

Hypotheses 6a-b. When compared to perceived national judicial arbitrariness, perceived local judicial arbitrariness will exhibit a stronger negative (a) direct and (b) indirect (moderating) influence on WOFSS formal contract utilization.

3. Methods

3.1. *Sample and data*

This study uses data collected from several sources. Data for most variables in this study came from a research survey we conducted in the Philippines from August through December of 2007. It was appropriate to use the Philippines as the data source for this study, as it is an emerging market (United Nations, 2007) that is a primary foreign investment location choice for MNE subsidiaries operating in Southeast Asia (Heinrich & Konan, 2001). Reports show foreign investor perceptions of uncertainty in Philippine legal system to be mixed during the time of this research study—some reports suggest perceptions of the legal system to be improving while others determined that foreign investor confidence in the legal system substantially weakened (Asian Development Bank, 2007).

This study utilizes WOFSS as the unit of analysis. We specifically target WOFSS because various types of subsidiary modes of entry (international joint ventures, alliances, etc.) are structured differently, as well as governed and constrained by the regulatory environment in very different ways (Li et al., 2007; Terpstra, Sarathy, & Russow, 2006). With this in mind, WOFSS have complete control over their operations, allowing for greater strategic autonomy and flexibility when operating in a foreign environment (Peng, 2016). Thus, using responses from WOFSS mitigated any potential differences arising from “governance characteristics” (Hillman & Wan, 2005: 329). For these reasons the legal system in the Philippines provides WOFSS with enormous opportunities as well as significant challenges and threats, providing the ideal context for this study.

We followed Dillman’s (2000) tailored design method to develop the questionnaire and administer the survey instrument. Measurement items utilized in this study are derived from the international business and strategic management literatures. We initially involved university business faculty in the Philippines and the U.S. to determine whether the content of the survey items correctly represented the conceptual domains of the main constructs we desired to test (Fowler, 1995), which led to improving the content validity of the measures included in the survey instrument. We used English as the language in the questionnaire because it is one of the primary languages native Filipinos speak and is universally spoken in the Filipino business community (Hinkelman, 1996). We pretested the questionnaire with executives and

managers of firms operating in the Philippines in order to determine the clarity of the survey items.

Our sample consists of 540 WOFSs randomly selected from the *Foreign Companies in the Philippines Yearbook* (2007). All WOFSs selected for this study were operational for a minimum of three years. This was important because the survey instrument required reflection over the past three years of the WOFS's operations in the Philippines. We asked reflective questions in order to “avoid capturing biased responses based on particular episodes of peak performance or even one-time negative relational experiences” (Mesquita & Lazzarini, 2008: 365).

We administered our survey instrument to key informants (senior executives and managers) of WOFSs operating in the Philippines. Further, the respondents were either senior executives who were in charge of the foreign subsidiary or managers who reported directly to the senior executive. We called the selected key informants to explain the study's purpose and request their participation and then made field visits to administer the questionnaire on-site which helped us gain access to the proper informants, ensured that they understood the terminology correctly, and provided us with the opportunity to increase the response rate (Li & Zhang, 2007). We did not use the postal service to deliver survey instruments because the Filipino postal system, as with many emerging market postal systems, was deemed a risky avenue for distribution (Hoskisson et al., 2000; Sawyerr, 1993). After we called each WOFS key informant, the researcher in charge of administering the questionnaire, the lead researcher and four appropriately trained interviewers, delivered the questionnaires and then set a date to pick up the questionnaire (see Acquah, 2007). To ensure that we had the largest number of participants and they would provide accurate responses, we included a cover letter that explained that the informants should not identify themselves, that we would keep their responses completely confidential, and that we would provide them with a summary of our findings (Lee & Miller, 1999; Podsakoff, MacKenzie, Lee, & Podsakoff, 2003).

The key informants were highly knowledgeable about the WOFS's operations (Luo, 2007) and were able to access pertinent company data (Julian & Ofori-Dankwa, 2008; Podsakoff & Organ, 1986). Research has shown that data collected from a single key informant is as reliable and valid as data collected from multiple respondents or secondary data (Li & Zhang, 2007; Miller, Cardinal, & Glick, 1997; Zahra & Covin, 1993). Thus, the targeted key informants possessed the knowledge required for this study, and they were reliable sources for the information requested on the survey (Bagozzi & Phillips, 1982; Li & Zhang, 2007).

Of the 194 questionnaires received, 13 were not usable due to missing data. This provided us with a sample of 181 questionnaires, a response rate of 33.5%, which was comparable to other studies performing similar methods of data collection (e.g., Li et al., 2007; Li & Zhang, 2007 38.6%, 2007). In order to triangulate the survey results, we conducted semi-structured interviews with 15 of the respondents in order to verify their answers were accurate and consistent (e.g., Krishnan, Martin, & Noorderhaven, 2006; Luo, 1999). We followed a similar procedure to Krishnan et al. (2006) and Luo (1999) by randomly interviewing the informants via telephone about aspects of their subsidiary's operations and strategic behavior. To make interpretation of the results easier, we used a three-point scale to categorize the responses. The interview responses were strongly consistent with the survey answers (Pearson correlations: 0.96–0.83, $p < 0.01$; Guttman split-half Rs: 0.82–0.71, $p < 0.01$).

We checked for non-response bias using the *Foreign Companies in the Philippines Yearbook* (2007). In doing this we compared size (number of employees) and experience (number of years operating in the Philippines) between responding and non-responding foreign subsidiaries. We analyzed the mean difference between responding and non-responding foreign subsidiaries with respect to size and experience with an unpaired *t*-test. All of the *t* statistics were insignificant ($p > 0.05$ level), providing support that the two groups were not

significantly different. This was further confirmed by running a logistic regression analysis using the same archival variables as predictors with the dependent (dichotomous) variable being coded as 1 for responding informants and 0 for non-responding informants; the regression coefficients did not sizably differ and none of the predictor variables were significant at the $p < 0.05$ level.

CEOs, general managers, managing directors, and other firm executives made up 54% of the responses. The remainder of responses (46%) were composed of senior vice presidents, regional heads, directors, and other senior managers. Of the respondents, 44% were foreign expatriates and 56% were local nationals. There was a wide range of industries represented in the sample, including electronics and electrical equipment (10.48%), construction and engineering (8.29%), chemicals (7.86%), various consultancies (7.42%), trade (7.42%), pharmaceuticals and medical care (6.98%), machinery and heavy equipment (6.98%), and banking/finance/insurance (6.55%).¹ The primary WOFS countries of origin included the U.S.A. (49), Japan (45), the U.K. (17), France (12), and Germany (10).² The mean size of the WOFSs was 460 and the mean number of years of experience operating in the Philippines was 29 years. Appendix A details WOFS country and regions of origin, WOFS characteristics, and respondent characteristics.

3.2. Variables and measurement

3.2.1. Dependent variable

Formal contract utilization (Cronbach's alpha = 0.83; communality loadings = 0.93–0.73) is measured by five items adapted from Park and Luo (2001). Following Fowler (1995) we modified the question based on earlier definitions plus our reading of studies on formal contracting (e.g., Luo, 2005; Poppo & Zenger, 2002; Reuer & Arino, 2002, 2007; Williamson, 1991). This measure indicates overall utilization of WOFS formal contracting relationships with local business actors. We asked informants to consider the past three years and rate the extent to which their foreign subsidiary used formal contracts and alliances with (1) buyers; (2) suppliers; (3) local business affiliates; (4) private banks and financial enterprises; and (5) competitors on a seven-point Likert-type scale (1 = “very little” to 7 = “very much”).

3.3. Predictor variables

We adopt uncertainty avoidance from the GLOBE study (House et al., 2004). Uncertainty avoidance is defined in the GLOBE study as “the extent to which members of collectives seek orderliness, consistency, structure, formalized procedures and laws to cover situations in their daily lives” (Sully de Luque & Javidan, 2004: 603). We employ this measure of uncertainty avoidance, as opposed to the Hofstede (1980, 2001) measure, because Venaik and Brewer (2010) have pointed out that Hofstede's uncertainty avoidance index mainly represents the stress component of the uncertainty avoidance construct while the GLOBE (House et al., 2004) uncertainty avoidance items are specifically focused on rule orientation. Further, we employ the GLOBE uncertainty avoidance practices (as is), rather than the values (should be), due to their fit with this study's overall research design as it relates to our interest in investigating the relationship between cultural related rule-based practices in responding to uncertainty and formal contracting.

We apply the World Governance Indicators (WGI) published by the

¹ Percentages are based on% of industry in total sample. Industry refers to the primary industry of a WOFS. Other industries not reported in the main text include agriculture/environmental (1.74%); consumer goods (4.34%); food and drink (3.93%); IT/computers/software (3.05%); mining/metals/steel (3.05%); motor industry (3.49%); oil and gas/energy (2.62%); printing/paper/media (2.18%); real estate and property (1.74%); telecoms/telecommunications (3.93%); textiles (1.31%); tourism/travel/leisure (1.74%); and transportation (5.24%).

² The remaining countries of origin include: Netherlands (6), Switzerland (6), Canada (4), P.R.China (4), Singapore (4), Australia (3), Belgium (3), Denmark (3), South Korea (3), Norway (2), South Africa (2), Sweden (2), Finland (1), Malaysia (1), and Mexico (1).

World Bank (Kaufmann, Kraay, and Mastruzzi, 2009) in order to measure home country rule of law (Cuervo-Cazzura & Genc, 2008). For each WOFS we code the respective indicator score based on its country of origin score (ranging from 0 to 100). We average the rule of law data over a four year period, with the last year being the year of the survey, to ensure stability and temporal precedence in our research design.

National judicial arbitrariness (Cronbach's alpha = 0.89; communality loadings = 0.72–0.66) assesses managerial perceptions concerning the lack of judicial strictness and impartiality in enforcing the laws at the national level within a host country. Local judicial arbitrariness (Cronbach's alpha = 0.94; communality loadings = 0.82–0.76) assesses managerial perceptions concerning the lack of judicial strictness and impartiality in enforcing the laws at the local, sub-national, level within a host country. Both of these variables are multi-item constructs created by adapting measures Luo (2007, 2005) used in previous research. Respondents were asked to consider the past three years and rate how strictly and impartially the Filipino (a) national (i.e., federal) and (b) local (i.e., city and provincial) judicial systems enforced (1) contract law; (2) intellectual and industrial property right protection law; and (3) foreign subsidiary law on a seven-point Likert-type scale (1 = "very low" to 7 = "very high").

3.4. Control variables

Informant nationality, informant host country experience, WOFS experience, WOFS size, industry growth rate, industry, market orientation, below aspiration performance level, parent country development, and parent resource protection are control variables. We employ the dummy variable informant nationality (coded 1 = Filipino, 0 = otherwise) because there may be a difference between the way local and foreign expatriate respondents perceive their subsidiary's contracting practices, resource protection strategies, and the host country judicial system, which could create a bias in the analysis (Luo, 2002). Informant host country experience is added to the analyses along similar theoretical lines. This variable is based on a question from the survey instrument which asked how many years the respondent spent working in the Philippines. *WOFS size* is derived from in the *Foreign Companies in the Philippines Yearbook (2007)*. We use this variable as a control because larger WOFSs tend to have more resources and a greater number of formal contractual relationships. *WOFS experience* also is derived from the *Foreign Companies in the Philippines Yearbook (2007)*. It is the number of years the WOFS had operated in the Philippines from its inception. We included it in the analysis because the number of years a WOFS is active in a host country is important in developing its ability to learn and strategically position itself in an emerging market environment (Li & Zhang, 2007; Luo, 1999).

Industry growth rate is measured by the compound growth rate (%) of the respective industry's sales from 2005 to 2007. We obtain this control variable from the *Philippine Statistical Yearbook (2007)*. We control for industry effects by employing dummy variables for technology oriented (industry dummy 1; coded 1 = technology and 0 = otherwise), and banking and finance oriented (industry dummy 2; coded 1 = banking and finance and 0 = otherwise) industries.³ These variables are derived from the *Philippine Statistical Yearbook (2007)*. We also control for market orientation (Luo, 2007) because local market dependence (as opposed to export orientation) could have an effect on contracting propensities of foreign subsidiary operations. This variable is coded 0 as export-oriented and 1 as local-market-focused. As with the other controls, the *Foreign Companies in the Philippines Yearbook (2007)* is used as the data source for this control.

³ We ran a series of robustness checks with other industry dummy variables (see Footnote 1). This process confirmed that the results for all statistical models did not significantly change when other industry dummy variables were substituted in the OLS analyses (Table 3).

Similar to Peterson, Pedersen, and Lyles (2008) we measure below aspiration performance level (Cronbach's alpha = 0.76; communality loadings = 0.80–0.78) by reverse coding and then aggregating two items taken from our survey instrument asking senior executives their perceived satisfaction with performance (sales level and net profit growth) of the WOFS on 7 point Likert type scales (Brouthers et al., 2000; cf. Park & Luo, 2001). We add this variable as a control in order to account for how performance below aspiration level may influence a foreign subsidiary's propensity to utilize formal contracting. Per Petersen et al. (2008: 1104), the two items are "reverse-coded, so dissatisfaction with performance level was taken as a proxy for recognition of performance below aspiration level". We also added home country development (hereinafter parent country development) as a control variable since foreign subsidiaries "with parents from developed countries often have strategic objectives that may differ from those with parents from developing countries when operating in an emerging market environment" (White et al., 2015: 349).

Parent country development is derived from the United Nations Millennium Development Indicators Database (2008) and is coded 1 if from a developed country, 0 otherwise. Lastly, parent resource protection is constructed and measured by two items adapted from Luo (2001). We asked informants to rate the extent to which their foreign subsidiary disagreed or agreed that (1) protecting resources, technologies, or knowledge are imperative to the subsidiary's achievement of the strategic goals underlying investment, and (2) our parent company protects firm-specific resources, technologies, or knowledge it commits to the subsidiary in order to gain greater benefits from such investment, over the past three years on a seven-point Likert-type scale (1 = "strongly disagree" to 7 = "strongly agree"). These items were then factored analyzed employing principal component analysis with Kaiser normalization using varimax rotation (Cronbach's alpha = 0.89; communality loadings = 0.76–0.75). The measurement items derived from the survey instrument are detailed in Appendix B.

3.5. Data analysis and results

An exploratory principal components factor analysis is performed on all key survey items to determine their construct validity, dimensionality, internal consistency, and item appropriateness. All item loadings for the multi-item constructs are significantly related to their underlying factor (ranging from 0.92 to 0.58) (Hair, Anderson, Tatham & Black, 1998). Also, the Cronbach's alpha of all constructs indicated they are reliable with alphas ranging from 0.94 to 0.84 (Hair et al., 1998). Prior research (e.g., Luo, 2007) finds that more detailed questionnaire items will result in higher reliability and construct validity of variables. Therefore, the modified items used in this study, taken from previously validated studies, exhibited high reliability.

To assess construct validity, we triangulated the survey data using field interviews, performed a confirmatory factor analysis and observed Harman's (1967) one-factor test (which is frequently used to indicate whether common method bias is a problem) (Podsakoff & Organ, 1986). Selected informants were interviewed and asked to identify specific traits regarding WOFS strategic behavior and the nature of the Philippine regulatory environment to provide triangulation with some of the survey results. The results exhibit high consistency between verbal reports and their questionnaire responses (see Sample and data section). We then ran a principal component factor analysis on all survey related items concerning formal contract utilization, perceived judicial arbitrariness, resource protection, and below aspiration performance level, yielding five distinct factors. All of the eigenvalues were greater than one, and the largest factor accounted for 26.28% of the total variance. There was no single factor that accounted for a majority of the variance. The scree plot also indicates that common method bias was not a problem (Li & Zhang, 2007). All Cronbach's alpha values were well above the 0.70 cut-off point (see Table 1).

To further confirm the validity of our constructs we tested for

Table 1
Results of principle component factor analysis for survey measures^{a,b}.

Items	Factor 1	Factor 2	Factor 3	Factor 4	Factor 5
Formal contract utilization					
1. Buyers	0.78	0.29	0.27	0.28	0.26
2. Suppliers	0.77	0.25	0.28	0.29	0.31
3. Competitors	0.93	0.24	0.09	0.11	0.12
4. Local business affiliates and associates	0.76	0.27	0.29	0.27	0.26
5. Private banks and financial enterprises	0.73	0.22	0.28	0.24	0.25
National judicial arbitrariness					
6. National judicial– contract law	0.30	0.66	0.35	0.25	0.14
7. National judicial– property right protection law	0.21	0.72	0.30	0.26	0.14
8. National judicial– foreign subsidiary law	0.24	0.68	0.30	0.19	0.07
Local judicial arbitrariness					
9. National judicial– contract law	0.36	0.31	0.78	0.33	0.12
10. Local judicial– property right protection law	0.28	0.34	0.76	0.37	0.23
11. Local judicial– foreign subsidiary law	0.27	0.25	0.82	0.21	0.08
Below aspiration performance level					
12. Sales level	0.29	0.25	0.25	0.80	0.13
13. Net profit Growth	0.34	0.26	0.23	0.78	0.12
Parent resource protection					
14. Protecting resources is imperative to strategic goals	0.28	0.25	0.30	0.15	0.76
15. Parent company protects resources commits to subsidiary	0.28	0.24	0.31	0.14	0.75
Eigenvalue	3.94	3.83	2.39	2.21	1.37
Proportion of variance accounted for (%)	26.28	25.58	15.96	14.76	9.14
Cumulative% of variance explained	26.28	51.87	67.83	82.60	91.75
Cronbach's alpha	0.84	0.89	0.94	0.81	0.89

^a Principal component analysis with Kaiser normalization using varimax (orthogonal) rotation.

^b Factor loadings that are greater than an absolute value of 0.45 are shown in bold font.

discriminant validity by conducting a chi-square test with structural equation modeling using AMOS (see generally Kline, 1998) and running all items on a single latent variable model and a multiple latent variable model.⁴ The chi-square's significantly improved from single latent variable to multiple latent variable models at the 0.01 level, supporting discriminant validity (Anderson & Gerbing, 1988). We also assessed multicollinearity through the computation of variance inflation factors (VIFs). VIFs for all variables were well below 10 (highest VIF = 3.56), indicating that multicollinearity did not seem to be a serious problem in our study (Hair et al., 1998). Thus, these tests demonstrated adequate overall validity of the constructs employed in this study (Table 2).

3.6. Tests of hypotheses

We performed a series of moderated hierarchical multiple regression analyses in order to test hypotheses 1 through 4. Tables 4 and 5 present these results. For all models, we reported results inclusive of control and predictor variables only, then inclusive of interaction terms, to indicate the robustness of coefficients to the inclusion or exclusion of interaction terms.

Model 1 reports the impact of all control variables on the extent of foreign subsidiary formal contract utilization. Informant home country ($\beta = 0.16$, $p < 0.10$), industry dummy 1 (banking and finance) ($\beta = 0.20$, $p < 0.05$), market orientation ($\beta = 0.14$, $p < 2.00$), and parent resource protection ($\beta = -0.23$, $p < 0.01$) has a significant effect on WOFS formal contract utilization. Hypothesis 1 states our prediction that WOFSs from home countries that are high in uncertainty avoidance are more likely to utilize formal contracts to govern interorganizational relationships with business actors in an emerging market

environment. The positive and significant coefficient ($\beta = 0.33$, $p < 0.01$) on the uncertainty avoidance measure in Model 2 supports Hypothesis 1, indicating that home country uncertainty avoidance is positively related to WOFS formal contract utilization.

Hypothesis 2 states our prediction that WOFSs from home countries that have a high rule of law are more likely to utilize formal contracts to govern interorganizational relationships with business actors in an emerging market environment. However, the results did not provide support for Hypothesis 2. Hypotheses 3a and 3b states that WOFSs which perceive host country (a) national and (b) local judicial arbitrariness to be high rather than low will be less likely to utilize formal contracts in governing interorganizational relationships. While the negative and significant coefficient ($\beta = -0.36$, $p < 0.01$) provides support for Hypothesis 3b (local judicial arbitrariness), Hypothesis 3a (national judicial arbitrariness) does not receive significant statistical support.

Model 3, in Table 3, provides results for the tests of Hypotheses 4a and 4b which posit that the positive relationship between home country uncertainty avoidance and formal contract utilization will be weaker for WOFSs that perceive host country (a) national and (b) local judicial arbitrariness to be high rather than low. While the negative and significant coefficient ($\beta = -0.14$, $p < 0.05$) provides support for Hypothesis 4b (the indirect effects of local judicial arbitrariness), Hypothesis 4a (the indirect effects of national judicial arbitrariness) does not receive significant statistical support.

To further validate and gain insight into the nature of this significant moderation effect we plot the interaction where perceived local judicial arbitrariness is treated as a contingency variable affecting the relationships between home country uncertainty avoidance on a WOFS's propensity to utilize formal contracts in an emerging market (Fig. 2). Corroborating the moderated hierarchical regression results, the slopes of the regression lines vary significantly (grow positively or negatively steeper) and reflect the change in perceived local judicial arbitrariness values from low (mean – one standard deviation) to high (mean + one standard deviation) (Aiken & West, 1991; Cohen, Cohen, & West, 2003). Specifically, the positive effect of home country

⁴ Structural equation modeling (SEM) was utilized in testing differences in chi-square in order to confirm discriminant validity (i.e., goodness of fit) between multiple versus single latent variables models. Our results confirmed that the multiple latent variable model had better goodness of fit and differences chi-squares significantly improved from the single to multiple latent variable model, revealing that common methods bias is not a serious concern in our data (e.g., Hair, Hult, Ringle, Sarstedt, & Thiele, 2017; Hair, Hult, Ringle, & Sarstedt, 2016).

Table 2
Descriptive statistics and correlations^a.

Variables	Mean	S.D.	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16
1. Formal contract utilization	3.25	1.57	-															
2. Home country uncertainty avoidance	4.09	0.30	0.15	-														
3. Home country rule of law	89.18	10.23	0.11	-0.46	-													
4. Local judicial arbitrariness	3.84	1.76	-0.44	0.17	0.20	-												
5. National judicial arbitrariness	4.01	1.65	-0.16	0.08	0.11	0.36	-											
1. Parent resource protection	5.13	1.58	0.24	0.07	-0.10	-0.25	-0.31	-										
2. Parent country development	0.97	0.15	-0.03	-0.23	0.19	-0.03	-0.03	-0.06	-									
8. Recognized below performance ^b	3.95	1.78	-0.05	0.02	-0.05	-0.07	-0.08	0.01	0.11	-								
9. Market orientation	0.74	0.43	0.30	0.04	-0.11	0.25	0.17	-0.16	-0.09	-0.09	-							
10. Industry dummy 1 (banking & finance)	0.08	0.28	0.25	-0.05	0.12	0.33	0.31	-0.36	0.07	0.18	0.18	-						
11. Industry dummy 2 (technology)	0.20	0.40	-0.05	-0.15	0.11	-0.11	-0.04	0.06	-0.02	-0.02	-0.10	-0.08	-					
12. Industry growth rate	9.17	9.94	0.21	-0.12	0.01	0.22	0.23	-0.15	0.03	0.01	0.18	0.28	0.20	-				
13. Foreign subsidiary experience	29.41	25.30	0.02	-0.19	0.09	0.14	0.10	-0.03	-0.01	0.03	0.03	0.03	0.01	0.14	-			
14. Foreign subsidiary size	460.54	864.54	-0.15	-0.10	0.03	0.02	0.01	-0.02	0.14	0.08	0.05	-0.29	-0.09	-0.15	0.28	-		
15. Informant host country work experience	14.55	8.05	-0.01	-0.15	0.09	-0.01	0.01	0.01	-0.02	-0.04	0.04	0.04	0.17	0.03	0.10	0.08	-	
16. Informant home country	0.56	0.49	0.08	-0.10	0.05	-0.01	0.01	0.02	-0.06	-0.01	0.11	0.05	0.19	0.01	0.05	0.06	0.69	-

^a N = 171. Correlations in bold are significant at the 0.05 level (two-tailed significance tests).

^b Recognized below aspiration performance level.

uncertainty avoidance on WOFS formal contract utilization becomes weaker when the perceived local judicial arbitrariness reaches a high level.

Model 4 in Table 3 provides results for the tests of Hypotheses 5a and 5b which posit that the positive relationship between home country rule of law and formal contract utilization will be weaker for WOFSs that perceive host country (a) national and (b) local judicial arbitrariness to be high rather than low. While the negative and significant coefficient ($\beta = -0.11, p < 0.10$) provides partial support for Hypothesis 5b (the indirect effects of perceived local judicial arbitrariness), Hypothesis 5a (the indirect effects of perceived national judicial arbitrariness) was not statistically significant.

To further validate and gain insight into the nature of the significant moderation effect, we plotted the interaction where perceived local judicial arbitrariness is treated as a contingency variable affecting the relationships between home country rule of law and a WOFS's propensity to utilize formal contracts in an emerging market (Fig. 3). Corroborating the moderated hierarchical regression results, the slopes of the regression lines vary significantly and reflect that the positive effect of home country rule of law on WOFS formal contract utilization becomes weaker when the perceived local judicial arbitrariness reach a high level.

Models 2 through 4 in Table 3 present the results for the tests of Hypotheses 6a and 6b, which predict that when compared to perceived national judicial arbitrariness, perceived local judicial arbitrariness will exhibit a stronger negative (a) direct and (b) indirect (moderating) influence on WOFS formal contract utilization. Perceived local judicial arbitrariness has a significant negative direct influence ($\beta = -0.36, p < 0.01$) on WOFS formal contract utilization. Perceived local judicial arbitrariness also has a significant negative moderating influence ($\beta = -0.14, p < 0.05$) on the relationship between home country uncertainty avoidance and WOFS formal contract utilization. Further, the fact that perceived local judicial arbitrariness has a significant negative moderating influence ($\beta = -0.11, p < 0.10$) on the relationship between home country rule of law and WOFS formal contract utilization, whereas perceived national judicial arbitrariness did not exhibit any form of direct or indirect influence on WOFS formal contract utilization provides support for Hypotheses 6a and b.

In sum, the predictive power of the models are strong with model fit and change in variance explained (Change in R^2) significantly improving from model to model. Also, the amount of variance explained substantially increased from model to model. Based on our results, there is strong empirical support for hypotheses 1, 3b, 4b, 5b, 6a, and 6b, suggesting that home country uncertainty avoidance as an imprinted organizational norm, rather than home country rule of law, will lead foreign subsidiaries to utilize formal contracts in governing inter-organizational relationships within their value chain. This positive relationship will diminish when local judicial arbitrariness is perceived to be high in a host country. A model of our study's findings is illustrated in Fig. 4.⁵

3.7. Discussion

This study attempts to extend the current state of the international

⁵ We ran a sensitivity check by utilizing multilevel modeling to account for nested data since the two primary independent variables of interest in our study (Home Country Uncertainty Avoidance and Home Country Rule of Law) are at the country level (acting as proxies for foreign subsidiary parent home country institutions). Our results, employing linear mixed models, establish similar results to the findings offered in our OLS regression analyses offered in Table 3 and Fig. 4. The estimates for the relationship between the predictor variables Home Country Uncertainty Avoidance ($p < +0.01$) and Home Country Rule of Law ($p < +0.10$), as well as the estimate for the interaction terms (Local Judicial Arbitrariness x Home Country Uncertainty Avoidance, $p < -0.05$; Local Judicial Arbitrariness x Home Country Rule of Law, $p < -0.10$), verify our findings. Furthermore, our sensitivity checks found similar results in terms of direction, magnitude, and significance, providing evidence for the robustness of our original results.

Table 3
Results of moderated hierarchical regression analyses ^{a, b, c}.

Variables	Formal Contract Utilization			
	Model 1	Model 2	Model 3	Model 4
Controls				
Informant home country	0.16(1.54) [†]	0.19(2.11) [†]	0.22(2.43) [†]	0.19(2.10) [†]
Informant host country experience	-0.11(-1.15)	-0.11(-1.19)	-0.13(-1.43)	-0.12(-1.26)
Foreign subsidiary experience	-0.08(-1.01)	-0.03(-0.41)	-0.03(-0.44)	-0.03(-0.46)
Foreign subsidiary size	-0.07(-0.95)	-0.08(-1.33)	-0.08(-1.32)	-0.08(-1.40)
Industry growth rate	0.07(0.96)	0.05(0.82)	0.06(0.90)	0.06(0.92)
Industry dummy 1 (banking & finance)	0.20(2.46) [*]	0.01(0.11)	0.01(0.17)	0.01(0.13)
Industry dummy 2 (technology)	-0.04(-0.56)	-0.02(-0.04)	-0.03(-0.44)	-0.02(-0.28)
Market orientation	0.14(2.00) [†]	0.14(2.04) [†]	0.12(1.86) [†]	0.12(1.88) [†]
Below aspiration performance level	-0.05(-0.74)	-0.03(-0.53)	-0.02(-0.26)	-0.03(-0.53)
Parent country development	0.03(0.39)	0.01(0.20)	0.01(0.09)	0.03(0.43)
Parent resource protection	-0.23(-2.56) ^{**}	-0.05(-0.62)	-0.05(-0.61)	-0.04(-0.50)
Predictors				
Uncertainty avoidance (UA) ^d		0.33(3.15) ^{**}	0.33(3.20) ^{**}	0.30(2.97) ^{**}
Rule of law (ROL) ^d		0.10(1.40)	0.14(1.72) [†]	0.15(1.77) [†]
National judicial arbitrariness (NPA) ^e		-0.04(0.45)	-0.06(-0.83)	-0.03(0.40)
Local judicial arbitrariness (LPA) ^e		-0.36(-3.43) ^{**}	-0.37(-3.60) ^{**}	-0.38(3.81) ^{**}
Interactions				
NJA x UA			0.07(0.83)	
LJA x UA			-0.14(2.42) [†]	
NJA x ROL				0.08(1.23)
LJA x ROL				-0.11(-1.77) [†]
R ²	0.23	0.51	0.53	0.52
Adjusted R ²	0.17	0.46	0.48	0.47
Change in R ²		0.28 ^{**}	0.02 ^{**}	0.01 [†]
Model F		18.45 ^{**}	6.34 ^{**}	2.80 [†]
Model df	160	156	158	158

^a N = 171. Values represent standardized coefficients (βs) with corresponding t-values in parentheses.

^b The mean-centering technique (Aiken & West, 1991) was used for all predictor and moderator terms.

^c The highest VIF value in the analyses (Model 4) is 3.56.

^d Home country.

^e Host country.

[†] p < 0.10.

^{*} p < 0.05.

^{**} p < 0.01 (two-tailed significance tests).

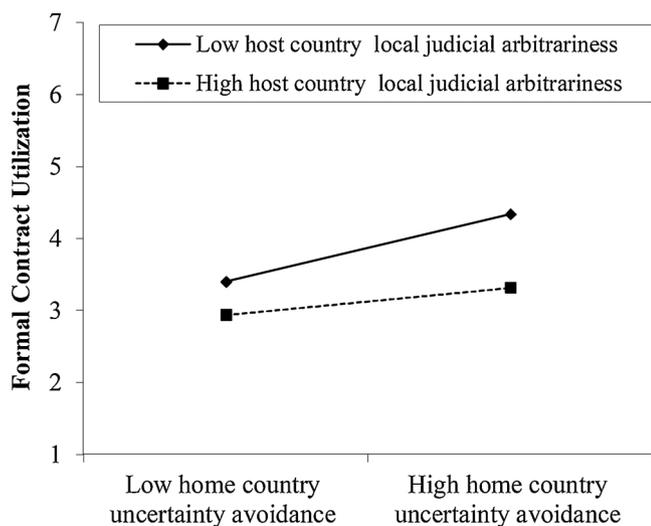


Fig. 2. Host country local judicial arbitrariness moderates the relationship between home country uncertainty avoidance and WOFS formal contractual utilization.

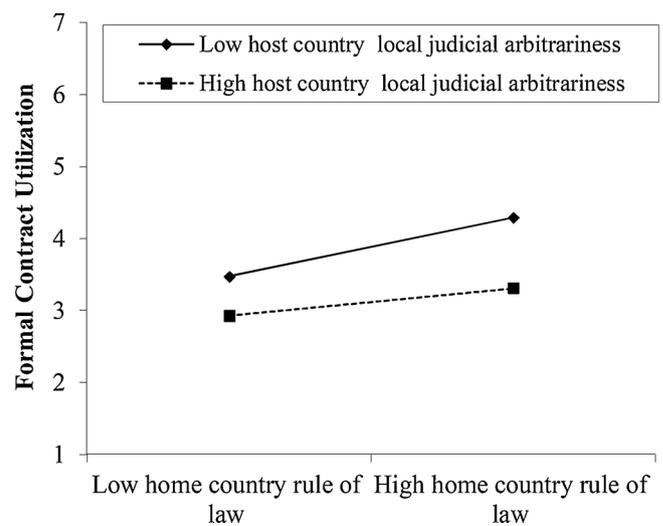


Fig. 3. Host country local perceived judicial arbitrariness moderates the relationship between home country rule of law and WOFS formal contractual utilization.

business literature by investigating the antecedents of WOFS formal contract utilization within its value chain in an emerging market environment. Building on the work of previously published formal contracting research (e.g., Luo, 2005; Poppo & Zenger, 2002; Reuer & Arino, 2002; Zhou & Poppo, 2010), this paper is the first to theorize and empirically test a conceptual model that considers why the level of

uncertainty avoidance and rule of law in a WOFS's home country, caused by the parent's transference of "institutionalized" practices derived from home country norms, will impact a WOFS's propensity to utilize formal contracts in governing host country interorganizational relationships. We further argue that managerial perceptions of host country judicial arbitrariness will diminish the positive relationship

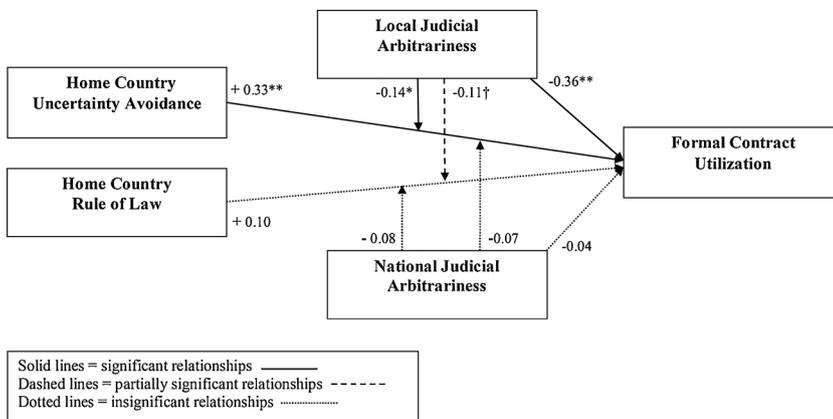


Fig. 4. Model of study's findings.

between home country uncertainty avoidance and utilization of formal contracts as governance mechanisms.

We have conceptualized how neo-institutional theory complements institution-based considerations as to the extent which WOFSS utilize formal contracts in governing interorganizational business relationships within value chain activities. Our study helps to enrich these theories by recognizing the tension that exists between home and host country institutional factors and their impact on the extent of WOFSS formal contracting. We have proposed that, while the IBV argues that host country institutional factors will be tied to managerial perceptions of judicial arbitrariness in enforcing court decisions, neo-institutional theory also suggests that variation in WOFSS utilization of formal contracts (as value chain governance mechanisms) can also be shaped by organizational practices stemming from parent home country institutional norms. This theoretical proposition is based on the notion that the legitimacy of a WOFSS's operations in a foreign market will be contingent on the continued support of the parent firm's "acceptance and approval" of strategic behavior in a host country. Thus, these home country norms may lead to institutionalized strategic practices within the MNE that are transferred to foreign subsidiaries.

More specifically, we theoretically considered that a WOFSS's propensity to utilize formal contracts in governing interorganizational relationships will be influenced by current institutional norms within its *home* country. We found this to be the case of parent home country uncertainty avoidance (as informal home country norms) but not the rule of law (as formal home country norms). Yet, at the same time, strategic decisions are often determined by senior manager perceptions of legal institutions and the subsequent influence of these *host* country legal institutions on their strategic choices in managing the daily operations of the WOFSS. The application of the IBV helps explain that, when compared to perceived national judicial arbitrariness, perceived local judicial arbitrariness will exhibit a stronger negative (a) direct influence on WOFSS formal contract utilization, and (b) moderating influence on the positive relationship between home country uncertainty avoidance and WOFSS formal contract utilization (see Table 3 and Fig. 4). This finding extends the IBV and is research opening in nature, suggesting that managerial perceptions of local (sub-national) institutions play a particularly important strategic role concerning the extent WOFSS utilize formal contracts governing interorganizational relationships.

Like all empirical studies, this paper has limitations. First, the data employed in this study are based on survey responses from single key informants. The use of single key informant data may pose potential problems, such as the limited recall of informants, biased perceptions of past actualities, and common method issues. However, we consider these key informants as strategic decision makers that are highly knowledgeable about their WOFSS's operations and represent a reliable source for information. Second, the dependent and moderating variables employed in this study are subjective measures. Acquiring

objective measures in the Philippines is extremely difficult, and our efforts were unsuccessful. This drove our choice to collect perceptual measures which are consistent with subsidiary literature in other emerging markets (e.g., Acquaah, 2007; Krishnan et al., 2006; Li & Zhang, 2007).

We also had limited access to information concerning parent firm strategy. Thus, while we were able to employ market orientation (which was positive and significant in all models, see Table 3) and parent resource protection (negative and significant in Model 1, see Table 3) to control for firm strategy, much could be done in future research assessing how there may be variation in the extent of formal contract utilization based on parent structure (e.g., international division, geographic area, global product, global matrix, etc.) and global strategy (e.g., localization, global standardization, transnational, etc.). Also, considering that informant home country was significant in Model 1 of the OLS regression analyses (see Table 3), this same perspective could be applied to future research studies investigating the potential link between MNE staffing approaches (e.g., ethnocentric, polycentric, and geocentric approaches) and how managerial perceptions of the institutional environment influences the extent of formal contract utilization.⁶

Future research could further validate and extend this paper's findings by employing similar research designs in other country contexts as well as explore the dyadic nature of formalized interorganizational relationships. With this in mind, we consider our study to be novel in employing neo-institutional theory and the GLOBE study's measure of uncertainty avoidance as a home country (country-of-origin) antecedent variable. However, we also recognize the limitations associated with nested effects of employing country level data when investigating how parent transference of "institutionalized" practices derived from home country norms will impact a WOFSS's propensity to utilize formal contracts in governing host country interorganizational relationships (see generally Footnote 5). Therefore, we recommend that future studies could further investigate these casual relationships by employing perceptual measures to capture greater variance in how managerial cognition of uncertainty avoidance influences a wide array of international business phenomena, such as foreign subsidiary post entry survival rates, government relations (i.e., bargaining power), and interorganizational conflict management practices.

Third, our dataset is cross-sectional rather than longitudinal, thereby making it difficult to gauge the complete causal relationships between home country uncertainty avoidance, perceived judicial arbitrariness, parent resource protection, and the extent of WOFSS formal contract utilization. For example, would the positive relationship between parent home country uncertainty avoidance and formal contract utilization hold over time as the WOFSS gains experience or grows in

⁶ We thank an anonymous reviewer for suggesting these avenues for future research.

size? Interestingly, neither WOFS experience, nor WOFS size, was significantly related to formal contract utilization in either the regression analysis or in the correlation matrix of the study. However, since the data for this study is a decade old, a natural extension of this study would be to further investigate the potential of these causal relationships having greater significance from a longitudinal perspective. Also, qualitative studies investigating the “sticky” nature of these relationships, such as differences in contracting behavior across industries, is warranted.⁷ For example, further qualitative analysis, similar to [Narooz and Child’s \(2017\)](#) study on networking responses to different levels of institutional voids, could investigate how managerial cognition of judicial arbitrariness in a host country may influence “institutional borrowing” of legal mechanisms to govern interorganizational relationships—such as mechanisms requiring legally binding international commercial arbitration—in order to bypass uncertain domestic courts ([Pinkham & Peng, 2017](#)).

Fourth, the empirical setting of this study was a single country. Although we consider the context of our study to be unique to the extant literature, and using a single country setting helps control for environmental factors, we do not know the extent to which WOFS formal contract utilization is context-specific. While we suggest that our results extend prior research and are generalizable to other emerging markets, further research across multiple country settings would provide greater insight into the utilization of formal contracting to govern interorganizational relationships by WOFSs.

Finally, our results suggest that WOFSs having parents headquartered in home countries with high uncertainty avoidance will seek structure and stability in governing interorganizational relationships through the utilization of formal contracts. Yet, these formal governance arrangements become less important to a WOFS when managers perceive the host country judicial system to lack credibility as an institution that can impartially and effectively enforce laws. Our example of Apple illustrates how MNEs can strategically utilize legal actions in judicial systems to resolve contractual issues against partners within their value chain for the purpose of “... preserv[ing] their rights, to protect[ing] valuable assets, and to create . . . competitive advantages” (e.g., [Casarin, 2015: 141](#)).

However, with the preceding in mind, our study offers insights as to

why managers must consider the tension and practical ramifications that may exist concerning the transference of uncertainty avoidance as parent organizational norms influencing the extent of formal contract utilization. This notion also applies to how managers of WOFSs may perceive the local, rather than national, judicial systems (i.e., are the courts or government legal departments perceived to be partial?) when enforcing laws associated with the governance of contractual arrangements in their value chain.

4. Conclusion

In this paper we have argued that neo-institutional theory complements institution-based considerations of WOFSs when utilizing formal contracts in governing interorganizational business relationships within value chain activities. By combining secondary data with unique primary data collected in the Philippines, we find that parent home country uncertainty avoidance does positively influence a WOFS’s propensity to utilize formal contracts in governing host country interorganizational relationships. We also find that managerial perceptions of host country judicial arbitrariness will diminish the positive relationship between home country uncertainty avoidance and the extent that WOFS utilizes formal contracts as governance mechanisms in its value chain. These findings suggest that manager perceptions of host country judicial rulings do play a significant role in how they formulate strategic decisions relating to formal contracting. These findings also clearly establish that the transference of strategic practices influenced by home country institutional norms and managerial perceptions of host country institutional norms *both* play a significant role in WOFS formal contracting. Furthermore, our results offer a fine-grained analysis establishing that tension does exist between home country contracting practices and host country managerial perceptions as they relate to strategic decision making that influences WOFS formal contract utilization. We believe that future research can build from our study by further exploring how the interaction between institutional norms that influence organizational strategic practices and managerial perceptions of institutions influence foreign subsidiary formal contracting practices governing interorganizational relationships in emerging markets.

Appendix A. Sample and respondent characteristics^a

WOFS country of origin	#	%
Australia	3	1.7
Belgium	3	1.7
Canada	4	2.2
Denmark	3	1.7
Finland	1	0.6
France	12	6.6
Germany	10	5.5
Japan	45	24.9
Malaysia	1	0.6
Mexico	1	0.6
Netherlands	6	3.3
Norway	2	1.1
P.R.China	4	2.2
Singapore	4	2.2
South Africa	2	1.1
South Korea	3	1.7
Sweden	2	1.1
Switzerland	6	3.3
United Kingdom	17	9.4

⁷ Only one industry dummy variable, Industry Dummy 1 (banking & finance), was significant in our analyses (see [Table 3, Model 1](#)). However, there is much room for micro-oriented qualitative research to comparatively explore the institutional drivers and underpinnings of foreign subsidiary formal contract utilization.

U.S.A.	49	27.1
<hr/>		
WOFS region of origin	#	%
Americas	54	29.8
Asia	60	33.1
Europe	65	36.0
Other	2	1.1

WOFS characteristics	Mean	Range
Employees	460.54	12–6000
Age	29.42	4 – 135

Respondent characteristics

CEO, managing director, general manager, country manager, other chief officer	54%
Senior VP, director, regional head, other senior manager	46%
Foreign national (versus host country local)	44%
Median levels between respondent and CEO	1
Mean years experience ^b	14.54

^a WOFS = wholly owned foreign subsidiary. Adopted from White et al. (2015).

^b In the Philippines.

Appendix B. Summary of items from the survey questionnaire

1. General Information

- A). What is your official job title with the subsidiary you are working for?
- B). What country are you originally from (what is your home country)?
- C). How long have you worked in the Philippines (number of years)?

2. Formal Contracts

(seven point Likert scale: 1 Very Little – 7 Very Much) (source: Park & Luo, 2001)

Please *circle* the number best describing the extent to which you and your firm have used *formal contracts and alliances* during the past three years with host country:

- A Buyers
- B Suppliers
- C Competitors
- D Local business affiliates and associates
- E Private banks and financial enterprises

3. Legal System Completeness

(seven point Likert scale: 1 Very Low – 7 Very High) (sources: Luo, 2007, 2005).

Using the past three years as a reference, please rate the extent to which you consider the following statements to be *LOW* or *HIGH* by *circling* the appropriate number in the scale beside each statement

In your observation how strict and impartial has the Philippine's national judicial system (courts, tribunals, and legal departments) enforced the following laws?

- A Contract law
- B Intellectual and industrial property right protection law
- C Foreign subsidiary law

In your observation how strict and impartial has the Philippine's judicial system (courts, tribunals, and legal departments) at the local level (city,

province, county) enforced the following laws?

- A Contract law
- B Intellectual and industrial property right protection law
- C Foreign subsidiary law

4. Parent Protection

(seven point Likert scale: 1 Strongly Disagree – 7 Strongly Agree) (source: Luo, 2001)

Using the past three years as a reference, please rate the extent to which you *DISAGREE* or *AGREE* with the following statements by circling the appropriate number in the scale beside each statement

- A Protecting resources, technologies, or knowledge are imperative to the subsidiary's achievement of the strategic goals underlying investment
- B Our parent company protects firm-specific resources, technologies, or knowledge it commits to the subsidiary in order to gain greater benefits from such investment

5. Subsidiary Performance

(seven point Likert scale: 1 Very Dissatisfied – 7 Very Satisfied) (sources: Brouthers et al., 2000; cf. Park & Luo, 2001)

Please circle the number best describing how *satisfied* you are with the subsidiary's *performance* in the following areas?

- A Net profit growth
- B Sales level

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