

**How do emerging multinational enterprises
release subsidiary initiatives located in advanced economies?**

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ABSTRACT

We revisit the relationship between headquarters and subsidiaries under the context of emerging multinational enterprises (EMNEs) and develop a new model for releasing the subsidiary initiative, a significant form of corporate entrepreneurship activities hosted in advanced economies. Drawing upon institutional theory and corporate entrepreneurship theory, we argue that mutual trust between headquarters and subsidiaries serves as a mediating mechanism linking formal institutional distance and subsidiary initiatives. Meanwhile, we propose that communication effectiveness between headquarter and subsidiary plays as a moderator upon such relationships. Communication between the headquarters and the subsidiary positively moderates the relationship from formal institutional distance to trust. A sample including 232 EMNEs with headquarters in China and subsidiaries in advanced economies largely support our model on subsidiary initiative. Our model provides a solution to the global integration-local responsiveness paradox.

Keywords: Subsidiary initiative; formal institutional distance; trust; communication effectiveness; headquarters-subsidiary relationship

1. Introduction

Brady and Woodward (2005: 201) depict how British Admiral Horatio Nelson won the Battle of Trafalgar:

Nelson spent considerable time developing his ship's captains. He met with them every chance he got to impart his fighting philosophy unto them. He held special dinners to get them acquainted with each other to foster better team work...., Nelson's preference was to rely on the ability of his fighting captains to make their own decisions in the heat of battle and to act on the philosophy he had so painstakingly taught them beforehand.

In a pell-mell battle, Nelson's individual captains developed the fighting *initiative* and "to see themselves as the *entrepreneurs* of battle" (McChrystal and Collins 2015: 135). Yet, how do subsidiaries of multinational enterprises from emerging economies (EMNEs) play their captain roles in exploring and boosting their entrepreneurial initiatives in the battlefields of advanced economies? While Nelson developed the trust relationship with his subsidiary captains, is there a similar trust relationship between EMNE's headquarters and their subsidiaries located in advanced economies with long formal institutional distances? If this trust relationship does exist, how does it consequentially affect their entrepreneurship performance, such as subsidiary initiatives? In addition, Nelson had effective communication with his captains. Correspondingly, how does communication effectiveness affect the two relationships above?

Similar to Nelson's subsidiary captains and their warships, subsidiaries of MNEs play important roles in identifying opportunities, developing initiatives, and subsequently exploiting such entrepreneurial opportunities in host countries (Ahsana and Fernhaber 2019; Clark and Ramachandran 2019), contributing to the development of MNEs' competitive advantages (Burger et al. 2018; Williams 2009). During the past two decades, numerous studies examine the headquarters-subsidary relationship (Meyer et al. 2020). As the overarching theoretical framework, agency theory has been extensively adopted to examine the headquarters-subsidary relationship, and headquarters and subsidiary resemble principal

and agent in the theory (Björkman et al. 2004; Filatotchev and Wright, 2011; Kostova et al. 2016). From such a simplified hierarchical perspective, headquarters take firm control of the subsidiaries and would make strategic decisions for the subsidiary. In analyzing this principle-agency relationship, scholars have investigated the use and effectiveness of various forms of control variables such as centralization, formalization, attention, power tensions, control and coordination, embeddedness, and hierarchy (Ambos et al. 2010; Beugelsdijk et al. 2017; Birkinshaw 1997; Andersson and Forsgren 2000; Conroy and Collings 2016; Du and Williams 2017; Figueiredo 2011; Yamin and Andersson 2011), which all originated from MNE research on advanced economies. For EMNEs, however, complex institutions in these countries bring disadvantages in global competition. The headquarters for these MNEs face tremendous shortcomings due to arriving late to the international markets both at the firm level and at the country level (Mathews, 2006), their lack of skill in managing multinational firms, and a negative international image (Luo and Tung 2007). Thus, for EMNEs, agency theory is inappropriate in analyzing the relationship between headquarters and subsidiaries. To solve this problem, we introduce a new theoretical framework, the “Nelson Touch” model in this paper.

It is widely accepted that firms can benefit from corporate entrepreneurship by achieving higher overall performance, foreign profit, and growth in revenue (Zahra and Garvis 2000). However, undertaking corporate entrepreneurship activity could also be very costly and risky (Miller 1983; Zahra 1991) and involve the commitment of time and resources in extremely uncertain environments as well as high discretion of subsidiaries to make critical decisions. Thus, similar to the flagship and individual warships relationship and the treacherous battle environment, the nature of headquarters-subsidiary relationships and corporate entrepreneurship creates a dilemma for MNEs--whether they should take firm control or grant enough autonomy to their subsidiaries (Wang et al. 2014). Such a dilemma, however, could

be solved by incorporating an old but crucial element of the relationship between two entities – trust, a key element in the “Nelson Touch” model.¹

This research thus contributes to the international business, corporate entrepreneurship, and institutional theory literature in the following ways. First, the study enriches our knowledge on the headquarters-subsidary relationship under the context of EMNEs with subsidiaries located in advanced economies. The current research on the headquarters-subsidary relationship mainly focuses on MNEs from advanced economies. In our research, we develop a “Nelson Touch” model to depict the management strategy of EMNEs. Such a model is critical to the EMNEs’ management strategy when subsidiaries are located in advanced countries with a higher level of rule of law. Our “Nelson Touch” model could be a solution to the “global integration-local responsiveness” paradox (Doz and Prahalad 1984). When the formal institutional distance is long, trust could be a useful management strategy to cultivate the entrepreneurial activities in subsidiaries. Meanwhile, communication effectiveness could help or do nothing on different occasions.

Second, our research enriches the literature of corporate entrepreneurship and subsidiary initiative, especially under the context of EMNEs. To alleviate the challenges of liability of foreignness, the headquarters of EMNEs need to give enough autonomy to their foreign subsidiaries. Third, the present research adds to our understanding of how institutional distance may affect a subsidiary’s engagement on local entrepreneurial activities. The extant literature mainly focuses on how small businesses could be affected by the institutional environment, while how corporate entrepreneurs can be affected by institutional factors is scarce. Through the lens of institutional theory, we find that when the formal institutional distance is greater, it will be challenging for headquarters to overcome the

¹ Horatio Nelson’s critical strategy is creating trust amongst his subsidiaries. See Wikipedia and related references https://en.wikipedia.org/wiki/Horatio_Nelson,_1st_Viscount_Nelson.

unfamiliarity hazards. By putting more trust in subsidiaries, such as granting more autonomy, the headquarters can gain more information about the local market, enhance local legitimacy, and share the local firm's reputational capital. Finally, the two-side data collection process also contributes to the methodology of corporate entrepreneurship research. Our new methods overcome the problem of the existing method only collecting data from either the headquarters or the subsidiary and is helpful in identifying two-side mechanisms inside MNEs.

2. Theory and hypotheses

2.1. The "Nelson Touch" model of subsidiary initiative

Initiating entrepreneurship within MNEs is a significant challenge (Gorgijevski et al. 2019), especially for subsidiaries located in geographically remote and culturally diverse settings. In this paper, we define a subsidiary initiative as a discrete, proactive undertaking that advances a new way to use the resources of a branch outside the home country of the multinational corporation (Birkinshaw and Ridderstråle 1999). The relationship between headquarters and subsidiaries can be both cooperative and conflicting. On one hand, a vertical interdependence exists between headquarters and subsidiaries. The headquarters commit resources and motivate subsidiaries to reach the organizational goal, while the subsidiaries, as a response, comply with the organizational strategy and contribute to the overall goal of MNEs by generating a profit and providing knowledge and locational advantages (Goold et al. 1994). On the other hand, subsidiaries are often confronted with various kinds of conflicts with headquarters due to the heterogeneity of cultures (Ayoko et al. 2002; Bouquet and Birkinshaw 2008), stakeholder interests (Zietsma and Winn 2007), or institutional contexts (Kostova et al. 2008). First, due to culture, geographic, and task distance, vast information asymmetry exists between headquarters and subsidiaries. The subsidiary possesses exclusive information that may result in opportunistic behavior. To

verify such information, headquarters have to commit substantial resources and time. Second, the headquarters and subsidiary have conflicting interests. The goals of subsidiaries are incompatible with the goal maximizing strategy of the headquarters of MNEs (Kaufmann and Roessing 2005). The local environment of a subsidiary always requires a different set of goals than headquarters can incorporate during the goal-setting period (Doz and Prahalad 1984). Meanwhile, subsidiary management is typically interested in short-term goals such as maximizing profit and sales while headquarters management emphasizes the collective and long-term goal of the whole organization. Third, conflict can be caused by the “global integration-local responsiveness” paradox (Doz and Prahalad 1984). The interdependence between headquarters and subsidiaries increases uncertainty and the necessity of information exchange in order to control subsidiaries, especially those located in geographically or culturally remote settings (Andersson et al. 2005; Doz 1980; Galbraith 1973). Therefore, Birkinshaw and Hood (2000) argued that the headquarters-subsidiary relationship is the most critical relationship of MNEs. Other scholars believe that little is known about the conflict between headquarters and subsidiaries within MNEs.

Despite the existing research about headquarters-subsidiary relationships and the importance of subsidiary initiative to MNEs’ entrepreneurship performance, there is a research gap regarding what kind of headquarters-subsidiary relationship and intra-organizational atmosphere is conducive to subsidiary initiative. To answer this question, we introduce a “Nelson Touch” model as the primary lens to examine the context of the headquarters-subsidiary relationship.

The “Nelson Touch” model, shown at the Battle of the Nile and the Battle of Trafalgar, includes sharing consciousness with captains with intensive training, delegating the crucial independent decisions to them, and treating themselves as the entrepreneurs of battle (Brady and Woodward 2005; McChrystal and Collins 2015). Similar to the extreme context in sea

battles, EMNEs face the environment (international market and subsidiaries) of volatility, uncertainty, complexity, and ambiguity (VUCA) to survive and thrive (Sun et al. 2018), and subsidiary initiative became every EMNEs' call to each captain. Thus, for headquarters of EMNEs, similar to Admiral Nelson in managing his captains, they should allocate enough discretion to the subsidiaries and keep the right amount of communication at the right time in order to encourage them to make entrepreneurial decisions.

2.2 Formal institutional distance, trust, and subsidiary initiative.

Distance has been identified as a major hurdle of trust-building between two entities. According to Deza and Deza (2006), distance refers to the opposite side of the degree of closeness between any two entities. In the context of MNEs, distance is defined as the differences between any two countries (Håkanson and Ambos 2010). It is widely accepted that greater distance is associated with greater difficulties to collect, analyze, and interpret information about the market where the subsidiary is located and to do business overseas (Håkanson and Ambos 2010). Scholars in international business and strategy have all examined the effect of different types of distance on firm performance. For example, Wilkinson et al. (2008) found that cultural distance has a significantly greater impact on subsidiary control mechanisms for newer subsidiaries. Besides the culture, geographic, and economic distance, institutional distance is another example of the differences between headquarters and subsidiary in MNE research. Institutional distance refers to the extent of disparity between host and home institutions (Kostova 1996). Such disparity works as both opportunities and challenges to the headquarters and subsidiaries of MNEs. Previous literature shows that institutional distance acts as a major cause of foreignness (Zaheer 1995). Even though the literature on distance is voluminous, we still lack a clear and consistent understanding of how distance may affect different organizational outcomes (Drogendijk and Zander 2010).

Institutional theories have been widely applied to study MNEs that operate under diverse institutional pressures and in multiple institutional environments (Xu and Shenkar 2002). Social actors, such as entrepreneurs and multinational enterprises, are embedded in different institutional environments that provide “the rules of the game” (North 1990). Generally speaking, there are two kinds of institutions, formal and informal. Formal institutions include political rules, laws, legal decisions, and economic issues (Peng 2003) that constrain the ways of private property rights, the development of skills and knowledge, access to finance, and labor relations (Whitley 2005). In contrast, informal institutions, which include codes of conduct and norms of behavior that are embedded in culture and ideology (Peng 2003), determine patterns of behavior such as identity, collaboration, and subordination (Kshetri 2018; Whitley 1999). In this paper, we focus on the formal institutional distance since most advanced economies, our major research setting, have different formal institutions from China, especially on rule of law institutions.

In research areas involving multiple players, such as supplier relations (Lane and Bachmann 1996; Moorman et al. 1992), joint ventures (Inkpen and Currall 1997), and strategic alliances in general (Ring and Van de Ven 1992; Zaheer and Venkatraman 1995), trust has been identified as a significant management mechanism. Besides control, trust has been suggested as an alternative source of confidence in partner cooperation (Ring and Van de Ven 1992, Das and Teng 1998). Trust has been defined in various ways under different social contexts and conditions. In our research, following Doney, Cannon, and Mullen (1998), we define trust as the willingness to rely on another partner and to adopt actions that may make one vulnerable to the other partners. A wealth of research has been done on trust. Extant literature shows that trust is a prerequisite for high-quality relationships and therefore business success (Kshetri 2018). Trust can reduce transaction costs (Dore 1983; Noordewier et al. 1990), improve manager-subsidiary relationships, establish competitive advantages,

strengthen strategic alliances (Browning et al. 1995; Gulati 1995), help the implementation of strategy and improve managerial coordination (McAllister 1995), and facilitate long-term inter-organizational relationships (Ganesan 1994; Ring and Van de Ven 1992). We choose trust as the key variable in our research for the following reasons. First, trust is an important management mechanism by MNEs, especially EMNEs who have less experiences in managing subsidiaries in advanced economies. Second, the relationship between trust and performance has been well-studied (Luo 2002, Gulati 1995). However, most of the research examined the economic performance such as profitability and return on investment, while the innovative performance such as subsidiary initiatives has been barely investigated.

The resulting “Nelson Touch” conceptual model on subsidiary initiative is shown in Fig.1.

[Insert Figure 1 about here]

2.3 Mediating effects of trust

How does formal institutional distance affect headquarters-subsidary trust? When the formal institutional distance between the headquarters and the subsidiary is high and the subsidiary is located in an advanced economy, the following mechanisms could take effect. First, compared with China, advanced economies are always characterized by better institutional environment and a higher level of rule of law (Petricevic and Teece 2019). For EMNEs with host countries from such advanced economies where the formal institutional distances are long, the chance of opportunistic behaviors of the local managers is smaller and the cost of not conforming to the law is higher than those of China. Thus, the better rule-of-law environment give the headquarters of EMNEs more confidence and security with their subsidiaries if they located in advanced economies. Second, managers from advanced economies usually have higher managerial skills and capability (Cuervo-Cazurra and Genc 2008; Yakob 2018) and better understanding of the local culture, norms, and institutional environment (Hofstede 1980). When EMNEs operate in advanced economies, they need the

local managers who have been trained and socialized within the firm for a period of time (Tan and Mahoney 2005; Goerzen and Beamish 2007). For example, after Geely acquired Volvo Car Corporation, Geely allocated plenty of discretion to Volvo's managers in Europe. As one of Volvo's managers said, "You really need to put effort into it, and it comes down to trust as well." (Yakob 2018). Third, the professionalism embodied in managers from advanced economies will further diminish the concern of agency problem of the EMNEs. Since the formal institutional environment of China is stable, the greater the formal institutional distance between China and the host country is, the stronger the above-mentioned mechanisms will take effects. Therefore:

Hypothesis 1. *The larger the formal institutional distance between the Chinese headquarters and the subsidiary in an advanced economy, the greater the trust between them.*

Previous literature shows that trust can promote various social processes, such as broad role definition, communal relationships, high confidence in others, help-seeking behavior, the free exchange of knowledge and information, the subjugation of personal needs and ego for the greater common good, and high involvement (Anderson and Williams 1996; Clark et al. 1987; Morrison 1994). This can then lead to the development of synergistic team relationships in an organizational setting and, in turn, can lead to superior performance (Jones and George 1998). For example, Nelson always invited groups of his captains to his flagship for dinner to build trust (Brady and Woodward 2005).

As a specific form of corporate entrepreneurship (Birkinshaw and Ridderstråle 1999), the subsidiary initiative has received more and more attention in entrepreneurship and international business research (Ambos et al. 2010; Schmid et al. 2014). A subsidiary initiative always starts from an overseas subsidiary of a multinational corporation, rather than

the headquarters. In our research, all the initiatives refer to foreign subsidiaries of Chinese MNEs.

Since subsidiary initiative is a unique type of corporate entrepreneurship, any factors that are beneficial to corporate entrepreneurship will be beneficial to the subsidiary initiative as well. Extant literature shows that the factors that could determine the entrepreneurial level of a corporation include management support, work discretion and autonomy, reward and reinforcement, time availability, organizational boundaries, communication climate, etc. (Rutherford and Holt 2007; Goodale et al. 2011). Factors that could determine the subsidiary initiatives level include subsidiary roles, HQ-subsidiary relationship, subsidiary leadership, etc. (Strutzenberger and Ambos 2014). Among these factors, headquarters support, work discretion, and time availability could be the consequences of trust between headquarters and subsidiaries. First, when the trust between headquarters and subsidiary is high, the subsidiary will receive more support from headquarters. The support, such as funding, talents, and technology, have all proved to be indispensable elements of innovation and corporate entrepreneurship. Second, higher trust between the headquarters and the subsidiary implies that the headquarters will give more discretion and autonomy to the subsidiary. As a result, the subsidiary has more freedom to allocate its time, resources, and energy to more innovation and riskier corporate entrepreneurship activities. Third, when the headquarters has high level trust of the subsidiary, due to either the good track record or the high capability of the subsidiary, it will exert less time pressure on the subsidiary. It also encourages the subsidiary to build the improvisation culture and the learning mentality on innovation (Bouée 2013; Lewin et al. 2017). The trust that headquarters grants subsidiaries is similar to how Nelson relied on the ability of his captains to make their own judgment and decisions in the heat of battles. Thus, the subsidiary can afford to work on some long-term, more innovative

projects rather than worry about short-term performance, such as revenue and profitability.

Therefore:

Hypothesis 2. *The greater the trust between the Chinese headquarters and the subsidiary in an advanced economy, the greater extent of the subsidiary initiative for Chinese MNEs.*

Institutional theory has been proven to be a popular theoretical lens in explaining entrepreneurship success (Shane and Foo 1999; Ahlstrom and Bruton, 2002) as well as international business performance (Chao & Kumar 2009). MNEs may confront a multitude of different and sometimes conflicting institutional pressures (Kostova 1999; Kostova et al. 2008). It has been shown that headquarters and subsidiaries have strong pressures and incentives to conform to countries' institutional profiles (Ang and Massingham 2007; Kostova and Roth 2002). However, as the third leading perspective in strategic management, institutional factors doesn't affect the performance of organizations directly but by shaping firms' strategies such as ownership positions and entry mode of subsidiaries (Gaur and Lu 2007), expatriate staffing levels (Gaur, Delios, and Singh 2007), international diversity (Chao and Kumar 2009), product diversification (Chao et al. 2012), market orientation (He, Brouthers, and Filatotchey 2018). As we argued in hypotheses 1 and 3, the greater the formal institutional distance, the greater trust the headquarters will grant to the subsidiaries. Higher trust, in turn, will enable subsidiaries to receive more support, such as time, funding, talents, technology, and discretion in conducting more and riskier activities such as subsidiary initiatives. As we know, trust-building is a time-consuming process and its effect on performance is not instant. Extensive research has been done to demonstrate the mediating effect of trust between drivers of trust and performance variables, such as fairness and productivity (Drescher et al. 2014), influence acceptance and efficiency (Robson, Katsikeas, and Bello, 2008), leadership and organizational commitment (Chiang and Wang, 2012). Therefore, we argue that trust mediates the relationship between formal institutional distance and subsidiary initiative.

Hypothesis 3. *The relationship between formal institutional distance and subsidiary initiative of Chinese MNEs is mediated by trust.*

2.4. Moderating effect of communication effectiveness

We also have communication effectiveness as the moderator in “Nelson Touch” model. Communication effectiveness has been found to be critical to organizational success and it is essential for the communication between members to be effective to reap the benefits of collaboration (Mohr and Nevin 1990). Timely and effective communication improves the connections and enhances performance in networks (Cheng et al. 2001; Morgan and Hunt 1994; Wagner and Buko 2005). Timely communication between partner firms fosters trust by resolving disputes and aligning perceptions and expectations (Moorman et al. 1993; Morgan and Hunt 1994). Previous research shows that effective communication is positively related to subsidiary initiative (Ghoshal and Bartlett 1988).

As to the relationship between formal institutional distance and trust, previous literature indicates that in an environment with greater formal institutional distance, the headquarters will lack knowledge and information about the politics and regulations in the host advanced economies (Kostova 1997). However, effective communication will increase the frequency, speed, and volume of headquarters-subsidary information exchange, thus helping the headquarters to better understand the subsidiary’s politics and regulations faster.

Meanwhile, effective communication can also help both sides to understand the aspirations of each other, to transfer organizational routines between each other, to manage conflict, and to facilitate daily operations to enhance coordination between each other (Luo and Shenkar 2006). Therefore:

Hypothesis 4. *Communication effectiveness between the headquarters and the subsidiary located in advanced economies positively moderates the relationship between formal institutional distance and trust for Chinese MNEs.*

As to the link between trust and subsidiary initiative, this relationship can also be moderated by communication effectiveness in two opposite ways.

Since higher trust between headquarters and subsidiary can lead to better headquarters support, work discretion, and time availability, we believe that communication effectiveness may strengthen the relationship between trust and subsidiary initiative. First, when the headquarters and the subsidiary can communicate effectively, they can exchange information about the innovation project more frequently, thoroughly, and in a timely manner (Wagner and Buko 2005). As a result, the headquarters is able to understand the progress and status of innovative projects of the subsidiary and to provide necessary support in time.

Second, while higher trust can help the subsidiary gain more discretion from the headquarters, better communication between them can help the headquarters make better decisions about the extent and scope of discretion it should grant to the subsidiary (Moorman et al. 1993; Morgan and Hunt 1994). If the innovation project proceeds well, more discretion can be granted. Otherwise, it can exert more control over the subsidiary. Therefore, efficient communication could build a shared consciousness between headquarters and subsidiaries on corporate entrepreneurship.

Third, with better communication, the headquarters can decide the proper amount of resources it can allocate to the subsidiary for its initiative. Either too many or too few resources can be detrimental to the development of the innovation project (Chen and Huang 2010; Lee and Wu 2016). Overall, the link between trust and subsidiary initiative will be stronger when headquarters-subsidary communication is more effective. Thus, we argue that:

***Hypothesis 5a.** Communication effectiveness between the headquarters and the subsidiary located in advanced economies positively moderates the relationship between trust and subsidiary initiative for Chinese MNEs.*

When trust between headquarters and subsidiaries has been established, the beneficial relationship could also be sabotaged by more communication. We know that higher trust between headquarters and subsidiaries could lead to better headquarters support, work discretion, and time availability. However, too much communication could turn into the so called “thick information exchange” which refers to open, meaningful, and frequent communication among network members (Uzzi 1997). “Thick information exchange” could jeopardize subsidiary initiatives in two ways. First, “thick information exchange” is time and resource consuming. This is especially true for MNEs whose subsidiaries are usually located in different countries and time zones. To convey, translate, and digest such information could consume considerable time and resources on both sides (Fidler and Johnson, 1984). As a result, subsidiaries could have less time and resources to spend on innovative projects. Second, we define subsidiary initiative as a discrete, proactive undertaking that advances a new way to use the resources of a branch outside the home country of the multinational corporation (Birkinshaw and Ridderstråle 1999). If a subsidiary wants to focus on innovative initiatives, it should work as a separate entity from its headquarters and without too many interferences. Too much communication will definitely hurt the autonomy a subsidiary should enjoy.

When the trust between the headquarters and the subsidiary is high, it will create an ideal environment for the subsidiary to conduct innovative initiatives. Too much communication could slow down the decision-making process of the subsidiary. Too much communication is also a signal of decreasing trust between each other. As a result, the advantage that trust can bring to subsidiary initiative will be undermined. As a result, higher communication

effectiveness could negatively affect the relationship between trust and subsidiary initiative. We then believe that trust and communication are complementary to each other in helping firms improve their subsidiary initiative performance. Thus, we argue that:

***Hypothesis 5b.** Communication effectiveness between the headquarters and the subsidiary located in advanced economies negatively moderates the relationship between trust and subsidiary initiative for Chinese MNEs.*

3. Methods

3.1. Data and sample

Our research context is in China, and we focus specifically on mainland Chinese MNEs that were engaged in outward foreign direct investment (FDI) projects. More than 13,500 firms in China had set up around 18,000 subsidiaries in 177 countries around the world, with a total amount of investment of 424,780 billion US dollars (report from Chinese Ministry of Commercial 2011). To construct the sample, we referred to the Statistical Bulletin of China's Outward FDI published by the Ministry of Commerce of China. According to the report, around 13,000 Chinese firms were involved in overseas FDI by 2010. However, since the list of firms is not disclosed by the Chinese government and was not accessible to researchers, the names of the outward-investing firms were identified from multiple sources published by the central and provincial Chinese governments. At the national level, 72 firms were extracted from the 2010 issue of the Statistical Bulletin of China's Outward FDI (OFDI). At the provincial and municipal levels, we identified 914 firms from provincial and municipal information service websites that provide lists of OFDI firms located in each province/municipality. After scanning the listed firms on the Shanghai and Shenzhen stock exchanges, we extracted 45 firms with OFDI. We also conducted a web search for firms conducting OFDI and thus identified another 350 firms. To ensure the reliability of the web

search, we further cross-checked the results by verifying the firms through business yellow pages and telephone directory services. At the end of the sample construction process, we had reached a sample of 1,381 firms engaged in OFDI activities.

Then we developed two sets of survey questionnaires targeting the top decision-makers working in the headquarters (Mainland China) and overseas subsidiaries of these firms. The respondents were senior executives such as CEO, general manager, owner, director, or senior manager who was directly in charge of the firm's FDI projects. For each firm, pairwise respondents, one from the headquarters and the other from the overseas subsidiary, were asked to complete the questionnaire. In the questionnaire, the respondents were asked to base their assessments on their firm's most recent overseas FDI project and respond to all questions with respect to that project. The questionnaire was initially developed in English and translated into Mandarin later by a bilingual expert. To examine the accuracy of the translation, we hired another bilingual expert to back-translate the questionnaire into English so that we could eliminate any translation errors.

To boost the response rate, we adopted a two-step procedure. In the first step, we contacted a representative from each firm by telephone and forwarded a detailed explanation of the research project via facsimile. In the second step, we distributed questionnaires to participants, one to the headquarters and the other to the subsidiary. Before the survey, we received consent from participants, reassuring them that the survey would remain confidential and answers would not be shared with the other member of their firm. We adopted a two-phase process to deliver the survey. First, questionnaires were sent to the identified respondent in the headquarters, after which three rounds of reminders followed via telephone and email during the next six weeks. The second phase started as soon as the questionnaires from the headquarters were received. During this phase, we distributed the questionnaires to the selected respondents of the overseas subsidiaries. Five rounds of reminders followed

during the next ten weeks. In the end, 392 pairs of questionnaires were collected from headquarters and subsidiaries. There is no multi-level issue in our data since each response was based upon a single overseas FDI project. After careful examination, we found that a total of 83 questionnaires were invalid. Thirty-four of those were incomplete, four firms were based in Hong Kong, and 45 questionnaires had missing values. After excluding those observations, our sample ended up with 299 valid observations, yielding a 22 percent response rate. Finally, using the World Bank Governance Index as the benchmark, we selected countries with Rule of Law Index larger than -0.41, which is China's score of Rule of Law in the World Bank Governance Index. We reason that those countries are more advanced in terms of institutional environment and should be an ideal sample for us to test our hypotheses. Our main sample then included 232 observations. In the post-hoc analysis, we used 67 other observations that included countries with a Rule of Law Index smaller than -0.41 (inferior institutional environment) as the second sample.

3.2. Common method bias

Since the data were collected via survey instruments (Podsakoff et al. 2003), common method bias was a potential concern (Chang et al. 2010). Two ex-ante measures suggested by Chang, Van Witteloostijin, and Eden(2010) were adopted to minimize the impact of common method bias. First, the dependent variables and independent variables were collected from different sources (Podsakoff et al. 2003). Further, our two-stage data collection procedures ensured that the subsidiary information was not collected until after the questionnaires from the headquarters were received. This measure helped us to reduce the likelihood that answers from both headquarters and subsidiaries were shared with each other. Second, to minimize the impact of social desirability, we made it clear in our survey that there were no right or wrong answers for all the questions and that the anonymity of respondents' identities, as well as the confidentiality of their responses, would be assured. According to Chang et al. (2010),

such data collection procedures encourage survey respondents to answer questions as honestly as possible so that the responses will be less biased.

We also examined common method bias with the two mainstream approaches. The first approach is the Harman one-factor analysis, which is a post hoc procedure to check whether a single factor is accountable for variance in the data (Chang et al. 2010). The 27 survey questions of four variables were examined using an unrotated, principal components factor analysis, and no single predominant factor emerged. If common method bias were present, a single factor would have emerged in this analysis. In addition, varimax rotation was applied to another round of factor analysis, limiting the solution to four factors. The results showed that the four factors and respective loadings of the items followed the a priori design of the instrument. In order of derivation, the four factors were subsidiary initiative, trust, formal institutional distance, and communication effectiveness.

The second method is the marker variable approach. We referred to the literature of Lindell and Whitney (2001) and adopted the following steps below to test the common method bias. First, we selected a marker variable “Learning Orientation” that has similar criterion of semantic content, close proximity, number of items, novelty of content, and narrowness of definition (Harrison et al. 1996). The marker variable is also theoretically irrelevant to the focal variables. Second, we calculated the hypothetical correlations among the four variables in our model plus the marker variable. The data support our model by confirming that the three theoretically relevant predictors have significant correlations with the criterion variable. Moreover, the correlations of the marker variable with the other predictor variables are low (0.12, 0.09, and 0.15). Communication effectiveness has a weak but significant relationship with the marker variable ($r = 0.15, p < 0.05$). Third, following the partial correlation procedure (Lindell and Whitney 2001), we calculated the attenuated correlation between the subject variables after the assessment of the effects from common

sources. The original correlations between subsidiary initiative and independent variables (trust, formal institutional distance, and communication effectiveness) were still significant after accounting for the common method variance. Thus, we can conclude that the correlations of subsidiary initiative and other independent variables cannot reasonably be accounted for common method variance and that these three variables still retain their practical significance in terms of a meaningful amount of variance explained.

3.3. Variables and measurements

3.3.1. Dependent variables

Following the work of Birkinshaw, Hood, and Jonsson (1998), we operationalize subsidiary initiative as a construct with five items (see the Appendix). A 5-point scale ranging from “1” (“strongly disagree”) to “5” (“strongly agree”) was employed in our research. The construct exhibits high reliability. The Cronbach’s alpha is 0.84 for the headquarters dataset and 0.81 for the subsidiaries’ dataset.

3.3.2. Independent Variables

Formal institutional distance represented the differences of politics and regulations between headquarters and subsidiary. To operationalize formal institutional distance, following Gaur and Lu (2007), we use seven items on topics such as government’s transparency, bureaucratic problems, and local authority’s independence to depict the formal institutions to conduct the business operation in a country. These items generated a Cronbach’s alpha of 0.77 in the headquarters dataset, and a Cronbach’s alpha of 0.75 in the subsidiary dataset.

Following the work of Ganesan (1994), we operationalized trust with seven items of 5-point scale. Each of the seven items captured different aspects of trust, such as frankness with

each other, reliability, openness, and honesty. The reliability of the variable is $\alpha = 0.74$ for the subsidiary dataset and $\alpha = 0.76$ for the headquarters dataset.

3.3.3. Moderation variable

Communication effectiveness was measured by eight items that evaluated the quality of formal and informal communications between the headquarters and subsidiary. Adapted from Anderson and Weitz (1989) and Menon, Bharadwaj, and Howell (1996), items such as whether the partner is candid, responsive, open, effective, and clear during communication are used to measure the extent of communication effectiveness. The variable generates a reliability of $\alpha = 0.80$ from the subsidiary respondents and $\alpha = 0.78$ from the headquarters respondents.

3.3.4. Control variables

A total of 11 control variables were included in our model. Size is operationalized as the log of the total assets of the focal parent firm. Following Chan and Makino (2007), we included three types of FDI motivation, market seeking, resource seeking, and asset seeking, as three dummy variables. We used variables *Hchingov* and *Hforeign* to control the ownership composition of the headquarters. When a firm decides to enter a foreign market, there are two entry modes. We used dummy variables *greenfield* and *acquisition* to control for the entry mode of the focal subsidiary. We included a dummy variable *strategy* to control for the marketing strategy of the firm's outward FDI. When it is equal to 1, it means that the firm uses a standardizes product or marketing strategy in different markets to reduce costs; otherwise, it means that the focal firm matches different national conditions by an extensively customized product offering or market strategy. The dummy variable *joint venture* was used to control whether the focal subsidiary is a joint venture (when it is equal to 1) or not (when it is equal to 0). We also controlled for industries of both headquarters and subsidiaries as

dummy variables. We used a dummy variable *country* to differentiate whether the subsidiary is located in developed countries (1) or developing countries (0).

4. Results

Table 1 shows the construct means, standard deviations, and correlations of all variables. The matrix shows that none of the correlation coefficients between variables is greater than 0.60. A correlation coefficient above 0.60 is considered to be high (Churchill 1991). We further checked the variance inflation factor (VIF) when performing the regression analysis procedures. In the final model, the VIFs of the key variables, trust, communication effectiveness, and formal institutional distance, are 2.17, 2.00, and 1.42, respectively, which are well below the suggested cut-off point of 10 and suggest that there is not significant multicollinearity problem in the data (Hair et al. 2010).

The values of factor loadings, Cronbach's alphas, composite reliability, and average variance extracted were also calculated to test internal reliability and convergent validity of the constructs. As shown in Table 2, all index values were above the recommended levels suggested by prior research (Anderson and Gerbing 1988; Hair et al. 2006).

[Insert Tables 1 and 2 here]

4.1. Hypothesis tests

Hypothesis 1 proposed that formal institutional distance (FID) between the headquarters and the subsidiary was positively associated with trust between them. Results regarding this hypothesis are shown in Model 2 of Table 3 and indicated that, as we expected in hypothesis 1, the formal institutional distance was positively related to trust ($\beta = 0.21, p < 0.001$).

Hypothesis 2 predicts that trust was positively related to subsidiary initiative. As shown in Model 4 of Table 3, Hypothesis 2 is supported by the results ($\beta = 0.22, p < 0.01$).

Hypothesis 3 indicated that trust mediates the relationship between formal institutional distance and subsidiary initiative. To test the mediating effect, we adopted the bootstrapping

analysis procedures with 5,000 replications (Efron and Tibshirani 1993; Mooney et al. 1993). Table 4 presents the results of the analysis. The results indicated that indirect effect from formal institutional distance to subsidiary initiative is 0.27, and such an indirect effect is 95% likely to range from 0.16 to 0.36, suggesting that the indirect effect was significant even it is small (Preacher and Hayes 2004).

Hypothesis 4 suggested a moderation effect of communication effectiveness on the relationship between formal institutional distance and trust. The result of Model 2 in Table 3 provide support of such a moderation effect ($\beta = 0.11, p < 0.01$). Consistent with our predictions, the relationship between formal institutional distance and trust was stronger when the communication effectiveness is higher between the headquarters and the subsidiary (refer to Figure 2).

Hypothesis 5a and 5b proposes a moderating role of communication effectiveness on the relationship between trust and subsidiary initiative. As shown in Model 4 of Table 3, communication effectiveness negatively moderates the link between trust and subsidiary initiative, but the effect is not significant. Thus, hypotheses 5a and 5b are not supported.

[Insert Tables 3 and 4 about here]

[Insert Figure 2 about here]

4.2. Robustness test

In the data analysis, we used the mean of headquarters and subsidiaries of each variable. For example, the value of “trust” in our model equals the mean of “trust” of each pair of headquarters and subsidiary. We conducted a robustness check by substituting the variables collected from the subsidiary side with variables collected from the headquarters side. For example, we changed the variable “trust” responded by subsidiary managers with “trust” responded by headquarters managers. We did the same exchange with variables communication effectiveness, formal institutional distance, and subsidiary initiative, and ran

the same models as in Table 3. The results were consistent in all the hypotheses that exhibit good robustness of our model and the quality of our data collection. We also checked the correlations between variables collected from both headquarters and subsidiaries. The correlations of the four main variables, subsidiary initiative, formal institutional distance, trust, and communication effectiveness, are 0.72, 0.68, 0.68, and 0.63, respectively, which exhibited acceptable agreement between headquarters and subsidiaries responses.

4.3. Post-hoc test

Previous literature shows that corporate entrepreneurship activities can help firms to achieve higher overall performance, such as profitability and growth (Bossak and Nagashima 1997; Zahra and Garvis 2000). We also conducted a post-hoc analysis by looking at how subsidiary initiative may affect headquarters' performance. We regressed subsidiary initiative on three different performance variables of headquarters, profitability, return on investment (ROI), and return on asset (ROA). As Models 5 and 6 show in Table 3, subsidiary initiative is positively associated with headquarters' profitability and ROI.

We also tested our hypotheses with the second sample of subsidiaries in emerging economies in which the Rule of Law Index is lower than that of China (N=67) and none of the relationships in our hypotheses is significant. It means that, for less advanced economies, higher formal institutional distance will not lead to higher trust between headquarters and subsidiaries located in them. Meanwhile, higher trust will not help with the subsidiary initiative. The two relationships mentioned above can't be improved with better communication effectiveness either. This result shows that the "Nelson Touch" model is only effective when Chinese MNE subsidiaries are located in advanced economies.

Since the measurement for formal institutional distance in our research was based on self-perception report, we did post hoc tests of the variable by combined country-level indicators

from two second data sources. The first institutional index is the Worldwide Governance Indicators (WGI) published by the World Bank.² There are two dimensions, "Regulatory Quality" and "Rule of Law," that are relevant to the formal institutional distance in our research. In the test, we substituted "Formal institutional distance" with each of the two indicators and reran the model. Unfortunately, hypothesis 1 is not supported by either indicator.

The second institutional index is from the Doing Business organization (www.doingbusiness.org). The Doing Business website provides objective measures of business regulations and their enforcement across 190 economies. After careful selection, we picked the variable "Law Enforcement" index as a substitution of the formal institutional distance in our research. The enforcement of regulations and laws is a vital dimension of formal institutional environment (North, 1989). To measure the discrepancy of two countries, we subtracted the Law Enforcement Index of China from each country, which is 80.9 according to the database, and the result is the new formal institutional distance. The new variable is not a perfect measurement of the formal institutional distance, but we believe it explains a large proportion of the variance of the variable. The result shows that both hypotheses 1 and 3 are supported.

5. Discussion

5.1 Theoretical contributions

Our study investigated how the formal institutional distance from an EMNEs country, which is China in this case, to host countries in advanced economies, can affect subsidiary initiative through trust between headquarters and subsidiaries. Meanwhile, we also examined the moderation effect of communication effectiveness on the relationships above. We

² More detail can be found in the link: <https://info.worldbank.org/governance/wgi/>

endeavor to make significant contributions to extant literature of international business, corporate entrepreneurship, and institutional theory literature.

First, we proposed and empirically examined a “Nelson Touch” model which is critical to the EMNEs’ management strategy when subsidiaries are located in advanced countries with higher level of rule of law. This model enriches the literature of corporate entrepreneurship and subsidiary initiative (Birkinshaw 1997; Birkinshaw et al. 1998), especially under the context of EMNEs. Our study shows that formal institutional distance is positively associated with the trust between headquarters and subsidiaries. Such a result can be explained by the reason that, in order to alleviate the challenges of liability of foreignness, the headquarters of EMNEs need to give enough autonomy to their foreign subsidiaries (Herrmann and Datta 2002; Rao et al. 1990; Wang et al. 2014). When the formal institutional distance is greater, it will be challenging for headquarters to overcome the unfamiliarity hazards (Makino and Delios 1996). By putting more trust in subsidiaries, such as granting more autonomy, the headquarters can gain more information about the local market, enhance local legitimacy, and share the local firm’s reputational capital (Yiu and Makino 2002). The result shows that, if the headquarters have greater formal institutional distances with their subsidiaries, rather than taking firm control and granting little discretion to subsidiaries, they will benefit more from subsidiaries if they allocate more trust to their foreign partners. On the other side, when subsidiaries have higher trust with their headquarters, they will have more autonomy, time, and resources to devote to entrepreneurial activities, which will, in turn, improve subsidiary initiative performance. Thus, our research also adds institutional theory as a new theoretical lens to the study of corporate entrepreneurship. The study successfully builds connections between formal institutional distance and subsidiary initiatives by introducing a new management mechanism, trust.

Second, our research findings also enrich the trust literature in international business. Our results also indicate that trust plays an important mediating role between formal institutional distance and subsidiary initiative. As we know, formal institutional distance refers to the extent of disparity between host and home institutions and such a disparity determines patterns of behavior such as trust, identity, collaboration, and subordination. While the invisible force of the formal institutional distance may affect subsidiaries' performance, it will not affect the performance in a direct way. Rather, such distance will determine the trust, identity, and collaboration between headquarters and subsidiary. Then the trust, identity, and collaboration will further influence the subsidiary's performance, such as profit, innovation, and initiative. Under such circumstances, each side of the dual relationship will play a complementary role to each other. The higher the difference between each other, the more trust they will grant to each other. The trust between the headquarters and the subsidiary plays as the media that the institution difference can exert its power through on subsidiary initiative.

Our results also reveal the important role communication effectiveness plays on the relationships between formal institutional distance and trust. Similar to Nelson's strategy, better communication skills with his captains, such as having special dinners for them and inviting them to his flagship, are proven to be instrumental in building the trust between them. However, communication effectiveness doesn't have a significant effect on the relationship between trust and subsidiary initiative. This result is interesting. It shows that when the high trust between the headquarters and the subsidiary is built, it will not be necessary to increase communication with the subsidiary. Similarly, in the case of Nelson's strategy, using signal flags in the sea battle to communicate between the flagship and other battleships might not do any good for the fleet. "Nelson's battle plans had been agreed with his captains in advance. As a result, having made his decision to attack at once, even though

night was falling, he was able to leave the detailed conduct of the action to his subordinates” (Brady and Woodward 2005: 215).

Third, our “Nelson Touch” model provides a solution to the “global integration-local responsiveness” paradox (Doz and Prahalad 1984). While the captain of each subsidiary makes independent decisions, EMNE could have high responsiveness to local engagement. At the same time, trust plays a fundamental role in bridging headquarters and subsidiaries with shared consciousness to integrate globally, even when the formal institutional distance between the headquarters and the subsidiary is long. Our robustness check further reveals that subsidiary initiative is beneficial to EMNEs headquarters’ performance, such as profitability and ROI.

5.2 Methodology contribution

Our two-side survey also contributes to the methodology of corporate entrepreneurship research. While the level or cross-level analysis is called in entrepreneurship research to identify the variables in individual, team, firm, region, industry, and national levels (Davidsson and Wiklund 2001), little attention has been paid to the hierarchical nature of corporate entrepreneurship. Some studies only collect data from the subsidiary side (Birkinshaw et al. 1998). We believe that this way only shows a partial story of the headquarters-subsidiary relationship. Our two-side methods overcome this problem through collecting data from the headquarters vis-à-vis the subsidiary respondents, and then identifying two-side mechanisms inside MNEs. The dyadic structure of the data further allows us to examine the effect of subsidiary initiative on the parent firm’s performance in the post-hoc analysis.

5.3. Implications for management practice

The findings bear some important practical implications. First, our research provides theoretical backup to EMNEs that give enough trust to their subsidiaries with whom they have high formal institutional distance. EMNEs have set up operations by acquisition, merger, and branch office in advanced economies during the past several decades. However, due to the disparity between host and home institutions, no single cooperation strategy can be applied to handle subsidiaries with different formal institutional distance. Meanwhile, different cooperation strategies may result in different performance consequences, such as profitability, revenue, innovation, and growth. Our research shows that, for EMNEs with subsidiaries located in advanced economies, when the formal institutional distance is high, it will be helpful for headquarters to grant more trust to subsidiaries, so they will have more freedom and autonomy to conduct entrepreneurial initiatives.

Second, our research shows that communication between the headquarters and the subsidiary is not always beneficial. On one hand, while the headquarters grants more trust to the subsidiary when the formal institutional distance is large, better communication between them can further strengthen such a positive relationship. On the other hand, while the subsidiary can benefit from a trustworthy relationship with the headquarters by improving its entrepreneurial initiative, more communication would not further improve such a benign relationship. Thus, headquarters of EMNEs should be selective when they communicate with their subsidiaries at different stages. At the early stage of the headquarters-subsidiary relationship, they should have more communication with each other, which is helpful in building a more trustworthy relationship. However, when the subsidiary starts to undertake any entrepreneurial projects that are innovative and risky, frequent communication with each other is not necessary.

5.4. Limitations and future research

Although the results of this research improved our understanding of the corporate entrepreneurship as well as EMNE strategy management, they are subject to a few limitations both empirically and theoretically. First, we focus on formal institutional distance between host and parent country in this study. Further research may add other dimensions, such as cultural and geographic distance, in the construct.

Second, although the study is carefully designed to measure the key variables such as trust, it did not include other possible mediators, such as centralization, formalization, and commitment, between formal institutional distance and subsidiary initiative. Although we found that trust fully mediated the relationship between formal institutional distance and subsidiary initiative in this research, formal institutional distance may also influence subsidiary initiative through other mechanisms not examined in the present study. Further research can be done to investigate the mediation effect of other variables between the formal institutional distance and subsidiary initiative.

Last and most interestingly, our study breaks new ground in international business research on the optimal level of communication at various stages of an evolving headquarters-subsidiary relationship. It opens the door to theory discourse on autonomy, embeddedness, attention, monitoring, and freedom of such dual relationships, especially for an emerging economy such as China with its individual formal institutional characteristics. In the past, we took for granted that activities such as communication should always be conducive to the relationship between two entities. However, our research reveals that communication has positive effect on the trustworthy relationship only at the early stage. In a similar vein, future research may examine activities and characteristics of MNEs, such as autonomy, attention, and monitoring, to see whether their effect varies at different stages.

5.5 Conclusion

Drawing upon institutional theory and corporate entrepreneurship theory, we develop a “Nelson Touch” model to depict how and when subsidiary initiative in EMNEs is released. The central premise of our model advocates the role of subsidiaries as entrepreneurs battling in foreign markets, and the success in this role is contingent on how the trust and communication between headquarters and subsidiaries transcend formal institutional barriers between home and host countries. We find that trust between headquarters and subsidiary plays as a mediator between formal institutional distance and subsidiary initiative. We also find that communication effectiveness positively moderates the relationship from formal institutional distance to trust but does not help subsidiary initiative after trust has been built. We hope the findings of this paper shed light on the relationship between formal institutional distance and subsidiary initiative of EMNEs with subsidiaries located in advanced economies. Inspired by the insights of Admiral Horatio Nelson, we postulate that the headquarters of EMNEs should follow the “Nelson Touch” model. In the model, the subsidiaries located in advanced economies could develop their own fighting initiatives and act as “the entrepreneurs of battle.”

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Table 1
Descriptive statistics and correlations of variables.

Variables	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17
1. SI	1																
2. FID	.37	1															
3. Trust	.36	.29	1														
4. CE	.22	.24	.56	1													
5. Age	.15	.09	.09	.02	1												
6. Size	.34	.22	.02	-.09	.32	1											
7. Government	.25	.25	.01	.01	.14	.28	1										
8. Foreign	.02	-.03	-.12	-.12	.18	.18	-.25	1									
9. Green Field	-.12	-.18	-.01	.04	-.09	-.28	-.06	-.23	1								
10. Acquisition	.14	.16	.11	.08	.15	.12	.09	-.04	-.46	1							
11. Market	-.01	.12	.18	.16	.02	-.10	.01	-.05	.06	.06	1						
12. Resource	.10	-.01	-.04	-.06	.08	.27	.06	.20	-.13	-.03	-.46	1					
13. Asset Seek	.08	.08	.14	.12	.05	.06	-.01	.11	-.07	.07	-.13	.02	1				
14. Country	.12	.12	.00	-.12	.17	.25	.11	.09	-.18	.08	-.12	.00	.04	1			
15. Joint Venture	-.06	.00	-.15	-.21	-.04	.15	.02	.28	-.50	-.51	-.12	.14	-.06	.11	1		
16. Total Assets	.27	.24	-.07	-.07	.19	.50	.38	.10	-.32	.09	-.10	.18	.00	.33	.22	1	
17. Strategy	-.01	.05	.03	-.04	-.13	.01	.02	-.02	-.01	.01	-.05	.10	.13	.05	-.01	.07	1
Mean	.10	.07	-.01	-.02	12.19	6.57	52.83	10.13	.24	.32	.70	.32	.23	.57	.36	21.55	1.34
Std. Dev.	.91	.94	.98	.99	8.26	2.35	41.29	16.34	.43	.03	.03	.03	.03	.03	.03	.18	.03

SI = subsidiary initiative; FID = formal institutional distance; CE = communication effectiveness

Significant correlations are highlighted in bold.

Table 2
The scale reliability and validity of measurement.

Construct	Item	Standardized Confirmatory Factor Analysis Loading	Cronbach's Alpha	Composite Reliability	Average Variance Extracted
Subsidiary Initiative	1	0.78	0.82	0.86	0.75
	2	0.83			
	3	0.73			
	4	0.86			
	5	0.81			
Formal Institutional Distance	1	0.74	0.76	0.79	0.73
	2	0.76			
	3	0.71			
	4	0.68			
	5	0.76			
	6	0.69			
	7	0.75			
Trust	1	0.69	0.73	0.77	0.73
	2	0.65			
	3	0.74			
	4	0.68			
	5	0.75			
	6	0.73			
	7	0.66			
Communication Effectiveness	1	0.83	0.79	0.85	0.76
	2	0.76			
	3	0.74			
	4	0.83			
	5	0.77			
	6	0.81			
	7	0.82			
	8	0.75			

Table 3
Results of regressions.

	Baseline	Model 1	Model 2	Baseline 2	Model 3	Model 4	Model 5	Model 6	Model 7
Dependent Variables	Trust	Trust	Trust	SI	SI	SI	Profitability	ROI	ROA
	Estimate (S.E.)	Estimate (S.E.)	Estimate (S.E.)	Estimate (S.E.)	Estimate (S.E.)	Estimate (S.E.)	Estimate (S.E.)	Estimate (S.E.)	Estimate (S.E.)
Independent Variables									
FID (H1)		0.16* (0.05)	0.21*** (0.05)		0.24*** (0.05)	0.25*** (0.05)	0.16** (0.05)	0.14** (0.06)	0.94 (1.18)
Trust (H2)					0.22*** (0.05)	0.21** (0.06)	0.04 (0.05)	0.09† (0.05)	0.44 (1.32)
SI							0.18** (0.06)	0.14** (0.05)	1.34 (1.49)
Interactions									
FID × CE (H3)			0.11* (0.04)						
Trust × CE (H4)						-0.02 (0.03)			
Moderator									
CE	0.59*** (0.05)	0.67*** (0.05)	0.50*** (0.05)	0.30*** (0.05)	0.11 (0.06)	0.11 † (0.06)	0.03 (0.05)	0.00 (0.05)	0.79 (1.29)
Control Variables									
Age	-0.01* (0.01)	-0.01* (0.01)	-0.02* (0.01)	-0.01 (0.01)	-0.01 (0.01)	-0.01 (0.01)	0.00 (0.01)	-0.01 (0.01)	0.11 (0.14)
Size	-0.02 (0.16)	-0.07 (0.15)	-0.07 (0.16)	-0.11 (0.14)	-0.10 (0.14)	0.08 (0.10)	0.00 (0.03)	-0.10 (0.14)	1.24 (0.56)
Government Share	0.03 (0.11)	0.11 (0.12)	0.10 (0.12)	0.13 (0.10)	0.13 (0.10)	0.09 (0.07)	0.00 (0.00)	0.13 (0.10)	-0.07* (0.03)

Table 3 (Continued)

	Baseline	Model 1	Model 2	Baseline 2	Model 3	Model 4	Model 5	Model 6	Model 7
Dependent Variables	Trust	Trust	Trust	SI	SI	SI	Profitability	ROI	ROA
	Estimate (S.E.)	Estimate (S.E.)	Estimate (S.E.)	Estimate (S.E.)	Estimate (S.E.)	Estimate (S.E.)	Estimate (S.E.)	Estimate (S.E.)	Estimate (S.E.)
Foreign Share	-0.13 (0.13)	-0.11 (0.13)	-0.09 (0.13)	-0.03 (0.12)	0.02 (0.12)	-0.08 (0.08)	0.00 (0.00)	0.03 (0.12)	-0.05 (0.07)
Country	0.09 (0.07)	0.08 (0.07)	0.08 (0.07)	0.10 (0.06)	0.11 (0.06)	0.06 (0.04)	0.02 (0.10)	0.11 (0.06)	0.24 (2.16)
Means of Establishment	-0.01 (0.01)	-0.01 (0.01)	-0.02 (0.01)	-0.01 (0.01)	-0.00 (0.01)	0.01 (0.01)	-0.01 (0.01)	-0.00 (0.01)	0.01 (0.01)
Primary Motivation	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)	0.00 (0.00)	0.00 (0.00)
Primary Strategy	-0.16 (0.10)	-0.08 (0.10)	-0.08 (0.10)	0.24** (0.09)	0.19* (0.09)	0.16** (0.06)	0.24** (0.09)	0.19* (0.09)	0.16** (0.06)
Joint Venture	-0.20* (0.09)	-0.18 (0.09)	-0.26 (0.16)	-0.23* (0.09)	-0.20* (0.09)	-0.14 (0.09)	-0.23* (0.09)	-0.20* (0.09)	-0.14 (0.09)
Internationalization	-0.16 (0.10)	-0.08 (0.10)	-0.08 (0.10)	0.24** (0.09)	0.19* (0.09)	0.16** (0.06)	0.24** (0.09)	0.19* (0.09)	0.16** (0.06)
Industry Effects	Controlled								
Constant	-0.74 (0.89)	-0.71 (0.87)	-0.32 (0.55)	1.14 (0.79)	0.03 (0.10)	-0.19 (0.48)	3.07*** (0.52)	2.28*** (0.51)	16.14 (11.39)
R ²	0.4669	0.6219	0.5087	0.3615	0.4305	0.4316	0.2292	0.2472	0.3023
Adjusted R ²	0.4327	0.5956	0.4722	0.3237	0.3943	0.3928	0.1853	0.1753	0.2441

Note: Seven industry dummies are included, but not reported here.

† p < 0.1; * p < 0.05; ** p < 0.01; *** p < 0.001

Table 4

Indirect effect of formal institutional distance on subsidiary initiative through trust

Mediator	Indirect Effect	Boot SE	Bias Corrected bootstrap 95% confidence interval	
			Lower	Upper
Trust	0.27	0.05	0.16	0.36

Note: bootstrapping based on n = 5000 subsamples

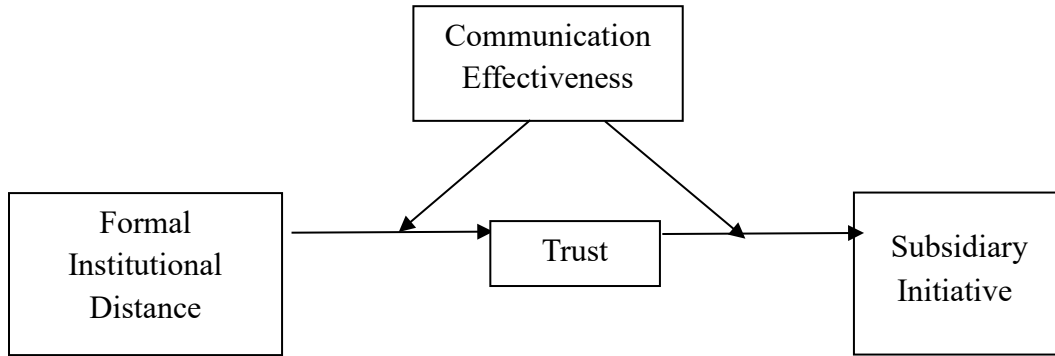


Figure 1. A theoretical model on subsidiary initiative

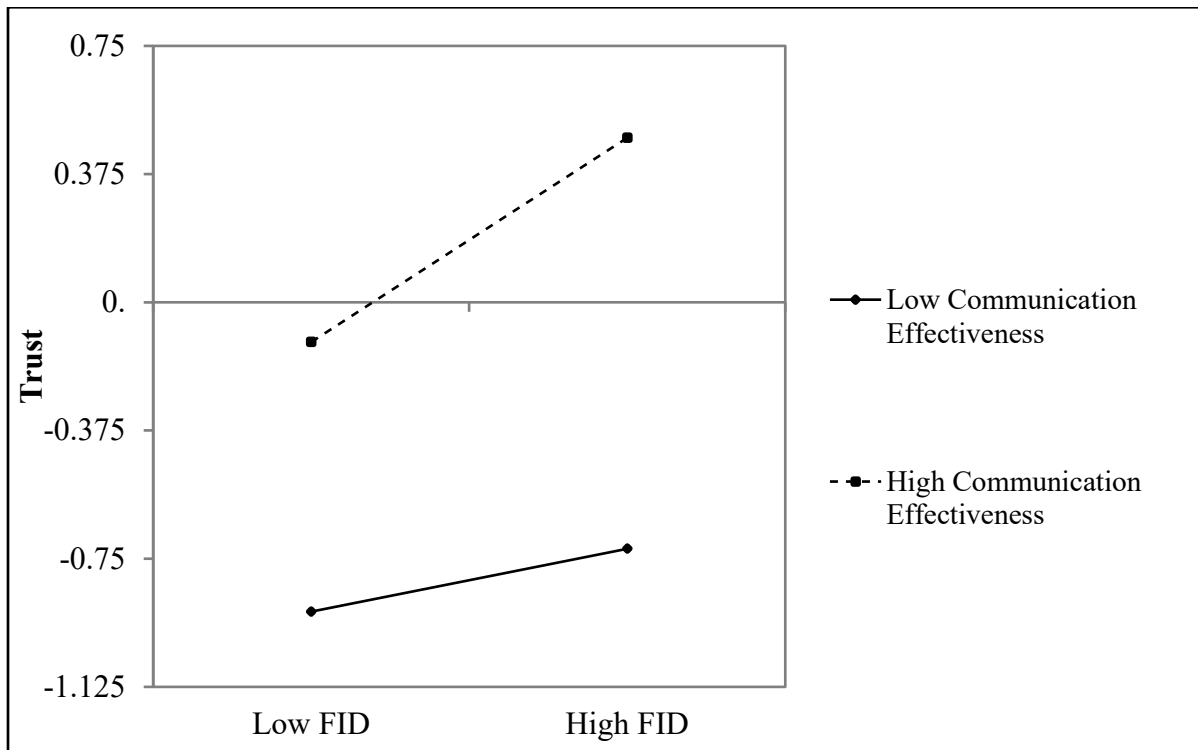


Figure 2. Moderating effect of communication effectiveness on the relationship between formal institutional distance and trust

APPENDIX

Measurement of institutional distance, trust, communication effectiveness, and subsidiary initiative.

A. Formal institutional distance (for subsidiaries) (Gaur and Lu 2007)

Please indicate your perceived levels of Formal Institutional Distance between China and host country:

1. Political system's adaptation to economic challenges.
2. Government policies' adaptation to economic realities.
3. Transparency of government toward its citizens.
4. Political risk.
5. Degree of bureaucracy hinders economic development.
6. Bureaucratic corruption.
7. Local authority's independence from central government.

B. Trust (for headquarters) (Ganesan 1994)

1. Sub has been frank in dealing with us.
2. Promises made by Sub are reliable.
3. Sub is knowledgeable regarding its operation.
4. Sub does not make false claims.
5. Sub is not open in dealing with us (R).
6. If problem arises, Sub is honest about it.
7. Sub has problems answering our questions (R).

C. Communication effectiveness (for headquarters) (Anderson and Weitz 1989; Menon et al. 1996)

1. We communicate candidly with each other.
2. Sub always tell us everything we need to know.
3. We are responsive to Sub's need for information.
4. Our communication is open and effective.
5. We have continuous interaction with each other.
6. We both communicate clearly.
7. Our staff communicate openly.
8. We have extensive formal and informal communication.

D. Subsidiary initiative (for headquarters and subsidiary) (Birkinshaw et al. 1998)

Please indicate to what extent have the following activities occurred in your subsidiary over the past 10 years?

1. New products developed in host country and then sold internationally.
2. Successful bids for corporate investments in host country.
3. New international business activities that were first started in host country.
4. Enhancements to product lines which are already sold internationally.
5. New corporate investments in R&D or manufacturing attracted by Chinese management.