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# FDI decisions and business-group insider control: Evidence from Taiwanese group-affiliated firms investing in the Chinese market

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## ABSTRACT

Based on resource-dependence theory, three hypotheses are developed and tested regarding the negative relationship between equity stakes in group-affiliated firms held by business-group headquarters and (1) the slack resources of group-affiliated firms, (2) the products of group-affiliated firms that are similar to those of the business-group headquarters, and (3) the human capital of group-affiliated firms. OLS regressions are used to test the hypotheses on a sample of existing group-affiliates of 218 business-groups entering the China market to establish a new affiliate, including 1015 observations during the 2004–2011 period. This study points to a new avenue for research on international business and business-group literature regarding ownership relations between group-affiliated firms and business-group headquarters.

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## 1. Introduction

China's share of flows of foreign direct investment (FDI) has increased dramatically in recent years. Most of China's FDI flows do not come from the advanced economies; rather, they come from the export-oriented economies among Asia's newly industrialized economies (NIEs) that are seeking to exploit China's low production costs (Whalley & Xin, 2010). For example, Taiwanese investments in China have grown dramatically, as shown in Fig. 1, focusing primarily on the labor-intensive and export-oriented manufacturing industries, such as textiles and garments, and food and beverage processing (Zhang, 2005).

In terms of NIE investments in China, the equity stakes of group-affiliated firms of business-group headquarters differ from one headquarters to the next. Two cases exemplify this interesting phenomenon. First, the business-group headquarters of Uni-President holds a 100% equity stake in Shanghai Songjiang President Enterprises, but it holds only a 73% equity stake in Beijing President Foods. Second, the business-group headquarters of Asustek holds 100% equity stakes in the group-affiliated firm of Shanghai Pegatron, but the business-group headquarters of Asustek holds equity stakes of only 32% in the group-affiliated firm of Suzhou Pegatron. With respect to business-group research, this situation presents the following question: why are there

differences among the equity stakes held by group-affiliated firms of the business-group headquarters?

To answer this question, especially with respect to ownership-based entry mode strategies, most of the existing international business (IB) literature focuses on transaction-cost theory (TCE) (Buckley & Casson, 1976; Anderson & Gatignon, 1986). However, TCE provides limited insights into explaining equity ownership decisions in the context of the emerging economies (EEs) because the EEs are often characterized by weak institutions (Wright, Filatotchev, Hoskisson & Peng, 2005). Additionally, in many cases these institutions are undergoing substantial reforms, which alter the nature of competition and firm strategies, such as their mode of foreign-market entry (Meyer, Estrin, Bhaumik, & Peng, 2009; Hitt, Li, & Xu, 2016) and strategic alliance partner selection (Hitt, Ahlstrom, Dacin, Levitas, & Svobodina, 2004). Some scholars argue that "the institution-based view can be thought of as the third leg of the strategy tripod, which, along with the industry competition view and the resource-based view, explains why firms make strategic choices" (Young, Tsai, Wang, Liu, & Ahlstrom, 2014). In a general sense, in the emerging market economies, institutional immaturity raises transaction costs and increases turbulence. Therefore, the organizations are more involved in strategic planning and resource allocations are more challenging, often requiring resources from other organizations to deal with the turbulent environment.

Resource-dependence theory (RDT) postulates that an organization is unable to generate all of the resources that are required to maintain its sustainability; thus, it must acquire resources from other organizations (Pfeffer & Salancik, 1978). Equity ownership is

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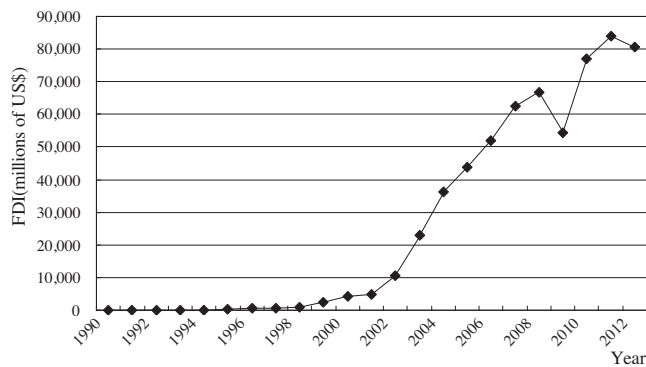


Fig. 1. Annual FDI inflows in China: 1990–2012.

not only a resource contribution but it is also indicative of the resource-dependence relationship between two actors. Based on the above explanations, in this study I use an institutional perspective and RDT to address the equity ownership decisions in the EEs where formal and informal institutions needed for more operating resources are lacking; the business-group headquarters is a powerful “core” company that is surrounded by offspring or descendant organizations – group affiliates or member firms – in which the business-group headquarters holds the dominant resources and thus has more resources to support affiliated firms to overcome the managerial complexity and the liability of foreignness in China. In particular, elements that may affect the need to rely on the business-group headquarters when dealing with market operations include slack resources, knowledge-based resources, and human capital.

I test my hypotheses on existing affiliates of business groups entering the China market to establish a new affiliate because there are more imports from Taiwan in China and there are differences in the amount of shares held by the business-group headquarters in their affiliates in the China market. I have used data for the 2004–2011 period with an ordinary least squares (OLS) regressions estimation technique.

Overall, the current study makes three contributions. First, most international business studies use transaction-cost theory to model managerial equity ownership as a function of the transaction costs, including bounded rationality, size, and specific assets (Hennart, 1989; Williamson, 1975, 1985; Teece, 1981) and to analyze the firms’ choice of entry mode when approaching new markets (e.g., Anderson & Gatignon, 1986; Cleeve, 1997; Tsang, 2000). However, despite its usefulness and its popularity among researchers, transaction-cost theory has been criticized for its narrow focus on efficiency with respect to decisions regarding the most appropriate entry mode (e.g., Chi & McGuire, 1996; Reuer & Tong, 2005). Equity ownership decisions are also influenced by resource-dependence relationships in the institutional environment. Second, by examining the intra-organizational relationship between the group headquarters and the group-affiliated firms, I expand upon previous RDT research that focuses only on actions, such as mergers or vertical integrations, joint ventures, boards of directors, political actions, and executive succession, that firms take to minimize environmental dependencies. Third, this study adds to our understanding of FDI flows from the NIEs to emerging economies by relating the patterns of outward FDI to the business-group organizational form that dominates many emerging economies.

## 2. Literature and hypotheses

### 2.1. Slack resources

The RDT perspective argues that an organization is unable to generate all of the required resources to maintain its sustainability.

Therefore, it must acquire resources from other organizations. This need renders the acquiring organization dependent upon the supplying organization. The strength of the dependence is contingent on how vital the desired resources are for the operations of the acquiring organization (Pfeffer & Salancik, 1978). Group-affiliated firms may have different organizational capabilities in terms of how to deal with fluctuating environments during periods of expansion, thus likely influencing the extent of their dependence on their headquarters.

Slack resources refer to the amount of “the pool of resources in an organization that is in excess of the minimum necessary to produce a given level of organizational output” (Nohria & Gulati, 1996: 1246). Affluent slack resources grant firms a greater degree of freedom to consider wide-ranging foreign-expansion possibilities without necessarily making compromises with respect to opportunities and allowing the expansion process to be less problematic (Ito & Rose, 2002; Mishina, Pollock, & Porac, 2004). Chinese market expansion, like other forms of expansion, requires more slack resources to buffer the costs and risks that are incurred owing to the greater managerial complexity and the liability of foreignness in China.

For example, the lack of institutional legitimacy creates higher transaction costs and renders market-based exchanges less efficient. Inadequate external institutions force firms to abandon their original long-term strategic plans and to adopt contingency planning in order to survive (Young et al., 2014). Second, the legal-political system in the EEs, compared to the developed markets, is highly bureaucratic, and corruption is rampant at all levels of government (Khanna, Palepu, & Sinha, 2005). Such a highly bureaucratic and corrupt legal-political governance system allows government officials to misuse political power (Bruton, Ahlstrom, & Li, 2010; Khanna & Palepu, 1997), thus creating uncertain “political markets” for firms to secure government support. Chinese legal-political governance, rather than being based on rules, is based on interpersonal relationships, and political decisions and legal enforcement are selective and “capricious” (Firth, Rui, & Wu, 2011: 573).

Thus, a failure to maintain a sufficient amount of slack resources may limit the capacity of group-affiliated firms to manage expansion in the Chinese market, which in turn will increase the likelihood that they will lag behind their rivals in the race to assume a leadership role. A group-affiliated firm that possesses fewer slack resources will be more dependent on support from its business-group headquarters. In such a situation, the headquarters are more likely to hold a higher equity stake in the group-affiliated firms. Accordingly, the hypothesized relationship between slack resources and the extent of the equity stake held by the headquarters is a negative linear relationship. In this regard, I propose the following hypothesis:

**Hypothesis 1.** The more slack resources that a group-affiliated firm possesses, the smaller the equity stake held by the business-group headquarters.

### 2.2. Product-specific knowledge

Group-affiliated firms operating in similar product areas when they enter China market have greater product-specific knowledge than group-affiliated firms operating in distant product areas. Harris and Helfat (1997) argue that product differences constrain the extent to which managerial skills can be transferred across various sectors. Related products lead to a reduction in operating costs because the given firm’s product-specific resources can be applicable to a number of products (Chatterjee, 1990).

Although the business-group headquarters may provide more product-specific knowledge to their affiliates when the products

of the group affiliates are similar to those of the headquarters, the headquarters' executives hope that the affiliates will have the ability to influence the scope of their own operations as well as to work more collaboratively with managers in sister affiliates rather than continuing to be dependent on the business-group headquarters. This is because affiliate dependence will result in headquarters' managers having to spend much time and effort planning and implementing trivial projects. The headquarters' primary goal is to allocate resources efficiently across the network of business-group affiliates in order to exploit more growth opportunities, while, at the same time, maintaining one focus. This involves seeking out potential investment opportunities, facilitating and coordinating the exchange of knowledge, and crafting joint strategic agendas with other business groups (Nohria & Ghoshal, 1994).

However, the affiliates' primary goal is to achieve those basic performance objectives that have been established by the business-group headquarters; once the affiliate managers have achieved those objectives that have been established by their headquarters, they will develop broader, or more ambitious, goals that not only will satisfy the expectations of the headquarters, but also will increase their own influence vis-à-vis other parts of the business-group network. For example, in China and Taiwan there are differences in terms of their respective institutional environments (Ahlstrom, Levitas, Hitt, Dacin, & Zhu, 2014); prior experience with similar products allows affiliate managers to spend less time and effort in determining how to modify processes for existing products in order to abide by the local formal rules, such as the laws, regulations, professional standards, and required procedures. Managers of the business-group affiliates have more time and energy to search for ways to enhance business-group power in the Chinese market, for example by developing social capital that allows them to interact with distributors in the Chinese market. Consequently, due to this enhanced power, the managers of other affiliates will become dependent on them. In such a case, managers of business-group affiliates are likely to influence peer business-group affiliates to use managerial resources more effectively. This will thus render group-affiliated firms less dependent on the headquarters.

In sum, the business-group headquarters and the business-group affiliates have different objectives. The business-group headquarters is a core entity offering common administrative and managerial coordination or financial control to its member firms, and its primary goal is to allocate resources efficiently to the entire organization. When affiliate firms manufacture products that are similar to those of the headquarters, the headquarters may be able to provide product-specific knowledge to the affiliates and they will encourage the affiliates to establish a common platform to share and exchange their own knowledge, experiences, and resources with other affiliated firms in the Chinese market rather than remaining highly dependent on the headquarters. Formally, business-group affiliations are independent, even though they are under common administrative and financial controls. Affiliates not only hope to acquire resources by cooperating with other affiliates, but they also hope to enlarge the scope of their own operations as well as to influence the strategies of the group. I thus hypothesize the following association:

**Hypothesis 2.** The equity stakes of the business-group headquarters are more likely to be lower when the group-affiliated firms manufacture products that are similar to those of the business-group headquarters.

### 2.3. Human capital

To be successful, firms must have appropriate resources for international expansion. However, possession of such resources is a necessary but insufficient condition to achieve a competitive

advantage. To achieve a competitive advantage, especially in international markets, such resources must also be managed effectively (Sirmon, Hitt, & Ireland, 2007). The human capital of the firm's managers performs this managerial role. Piazza-Georgi (2002: 463) defines human capital as "a stock of personal skills that economic agents have at their disposal." Rauch, Frese and Utsch (2005) note that human capital includes an individual's education, experiences, and skills that help in the tasks to complete one's work.

Signaling theory proposes that managers with greater human capital have access to greater resources (Spence, 1974; Hsu, 2007); this is called the "wealth effect" of human capital. Managers of group-affiliated firms with stronger human capital can help the firm integrate and reconfigure organizational capabilities to rapidly deal with the institutional immaturity, thus decreasing the transaction costs and risk levels. For example, firms with high levels of human capital are better able to build political capabilities. These capabilities guarantee success via-à-vis undeveloped institutions through enhanced negotiations, campaign contributions, and the formation of coalitions and networks (Jiménez, Luis-Rico, & Benito-Osorio, 2014). Likewise, Hitt, Bierman, Uhlenbruck and Shimizu (2006) argue that firms with strong human capital can exploit resources by capturing opportunities. Moreover, one type of such human capital is derived from international experience that strengthens personal networks. This is particularly important in the emerging economies where networks and relationships often compensate for gaps in the institutional framework (Peng, 2003; Meyer et al., 2009).

As such, group-affiliated firms can develop political capabilities that allow them to interact with the authorities of the host country in more appropriate ways in order to cope with the underdeveloped governance, legal, and financial institutions in the China market. Thus, managers of group-affiliated firms with human capital represent a potential source of competitive advantage. The resources of the business-group headquarters become less important as group-affiliated firms with human capital have an adequate level of resources and political capabilities. Given the above arguments, I posit the following:

**Hypothesis 3.** Business-group headquarters are less likely to hold higher equity stakes in group-affiliated firms that have human capital than they have in group-affiliated firms that have no human capital.

## 3. Methods

### 3.1. Sample and data sources

Business groups in Taiwan offer an ideal testing ground for the above hypotheses for three reasons. First, the sales of Taiwan's top 100 groups as a share of the gross national product increased from 28% in 1981 to 167% in 2013. This increase shows that business groups have become an increasingly dominant feature in Taiwan's economy. Second, because of the opening of trade between Taiwan and China since 2000, many business groups in Taiwan have moved their investments to China (Jaw & Liu, 2004) and have reduced their FDI in Southeast Asia. For example, the Want Want Group has established 34 sales branches and 356 sales offices in China, and the Dachan Greatwall Group has invested in an animal feed factory in Shenyang and a flour mill in Guangzhou. Third, there are differences in the amount of shares held by the various business-group headquarters in their various Chinese affiliates.

The source for my data is the biennial directory, *Business Groups in Taiwan (BGT)*, compiled by the China Credit Information Service (CCIS), which is Taiwan's most prestigious credit-rating agency. Indeed, the directory, used also in many previous studies, is

currently the most comprehensive source on business groups in Taiwan (Chung & Luo, 2008a, 2008b; Luo, Chung, & Sobczak, 2009; Tan & Meyer, 2010).

The CCIS employs the following criteria to identify a firm's membership in a business group: (1) more than 50% of the shares of each affiliated company are held by citizens of Taiwan; (2) there exist at least three affiliated companies (including the core company) as constituents of the group; (3) among the affiliated companies, at least half of the members of their boards of directors, auditors, executive stockholders, representative stockholders, and CEOs are family members or hold overlapping positions; (4) the total sales or assets of the group exceed NT\$5 billion; and (5) the core company is located in Taiwan.

My initial sample consisted of the top 300 Taiwanese business groups, excluding those in the financial sector. I then collected business groups listed in the 2006 through the 2012 editions of the CCIS directories, covering the period from 2004 through 2011<sup>1</sup> because all of the hypotheses focus on the dependency relationship between existing affiliates and the group headquarters. Existing affiliates of business groups entering the China market to establish a new affiliate are employed in the sample.

In total, I ended up with a sample of 2184 observations for 253 business groups during the period from 2004 through 2011. I deleted the group-affiliated firms that had missing values. Thus, the final sample consisted of 1015 observations covering 218 business groups.

### 3.2. Variables and measures

#### 3.2.1. Business-group headquarters' ownership (BGHO) in Chinese affiliates

This study uses the equity stakes of a new Chinese affiliate established by existing group-affiliates held by group headquarters.

#### 3.2.2. Slack resources

Bourgeois and Singh (1983) introduce three components to classify slack, and they rank these components in order of decreasing accessibility: available slack, recoverable slack, and potential slack. Others, such as Singh (1986), Bromiley (1991), and Greve (2003), maintain the distinctions among these three categories. More recently, Chang and Rhee (2011) have emphasized that potential slack, especially firm leverage, enables organizations to adapt to risky long-term investments. They also show that the leverage ratio serves as an important indicator of a firm's ability to support market expansion via debt financing, but available slack, or recoverable slack, often measured by the current ratio of sales and general expenses to sales, essentially reflects a short-term improvement in operating efficiency, and therefore it is less likely to affect the long-term effectiveness of market expansions, which inherently are risky long-term investments. Thus, potential slack is an important proxy for a subsidiary. I operationalize this by using the debt to equity (D/E) ratio.

#### 3.2.3. Product similarities

This study follows the approach first proposed by Hennart (1991). Product similarities are measured by means of a dummy variable equal to one if the products produced by the group-affiliated firms match those produced by the business-group headquarters; otherwise it is zero. The indices for the product similarities are based on the standard industry classification (SIC) codes. Because there are no ready-made SIC codes in the BGT directory, two coders manually verified the 4-digit SIC codes for each affiliate on the basis of its main products.

<sup>1</sup> Table A1 compares the various editions of the CCIS directories and the relevant fiscal years.

#### 3.2.4. Human capital

This study focuses on a major source of human capital for group-affiliated firms—international experience that managers accumulate during their work assignments. Managers with international experience have developed personal networks that aid in the building of political capabilities. A managerial Chinese market experience takes the value of one if the chairman of the group affiliates had previous Chinese market experience, and zero otherwise. Because no secondary data were available for this variable, I used a survey to obtain data on the Chinese market experience of group-affiliated firms.

#### 3.2.5. Control variables

My control variables are variables identified in previous research as important determinants that explain the relevant dependency relationships. The variables include the industry effect, temporal effect, the age of the group-affiliated firms, the size of the group-affiliated firms, the performance of the group-affiliated firms, the international experience of the group-affiliated firms, and the location of the group-affiliated firms. Year dummies were entered in order to control for the temporal effects. To control for the industry, I introduced dummy variables for the high-tech industries (precision machinery, electronic components, computers and peripherals, and telecommunications), heavy industries (shipping and transportation, automobiles, iron and steel, electronics and machinery, electricity and cables, chemicals, plastics, rubber, cement, glass products, and construction), and the consumer and light industries (paper and pulp, food, textiles, department stores, and tourism).<sup>2</sup>

Previous studies have shown that the age of the group-affiliated firms is an important proxy for the firms' ability to accumulate subsidiaries and age has a significant effect on the interdependence between a given subsidiary and the business-group headquarters. For example, older group-affiliated firms may have developed more extensive managerial networks to manage international growth on their own (Tan & Meyer, 2010). The *age of the group-affiliated firm* was calculated as the difference between the current year data and the subsidiary's year of entry. The size of a group-affiliated firm is typically related to the extent of its international activities; size indicates strong capabilities and an abundance of resources to deal with the complexities of foreign information (Henderson & Fredrickson, 1996). But a large size also implies increased information flows and a resultant expansion of volume and complexity of decision-making, which requires increased managerial inputs from the business-group headquarters. This, in turn, will result in increased dependence on the headquarters (Johnston & Menguc, 2007). Thus, I controlled for the size of the group-affiliated firms. The *size of the group-affiliated firm* was measured as the logarithm of sales in a given year. The more international experience that a group-affiliated firm has, the richer and more accurate are its cognitive maps of foreign conditions likely to be, enabling the firm to better adapt to a given foreign environment (Barkema & Shvyrkov, 2007). Thus, I controlled for the *international experience of the group-affiliated firm*, which took the value of one if the manager of the group-affiliated firm had foreign work experience, and zero otherwise. Poor performance may limit a group-affiliated firm's ability to enter foreign markets (Hitt et al., 2006). The performance of a group-affiliated firm was included as a control variable and was calculated as the three-year average of returns on assets (ROA). The location and equity shareholding of the parent company in its Chinese affiliate are interrelated because the locations of group-affiliated firms in the Chinese market presents different levels of risk for

<sup>2</sup> Consumer and light industries constitute the reference group.

potential foreign investors (Strange, Filatotchev, Lien, & Piesse, 2009). Following Strange, Filatotchev, Lien et al. (2009), I grouped the Chinese location into three regions based on the extent of the economic and political risks: Southern Coast = 1, Central Coast = 2, and Northern Coast = 3. A lower number represented a smaller risk.<sup>3</sup>

Finally, this study consists of 1015 observations from 218 business group; therefore, the group characteristics may have an effect on the BGHO in the Chinese affiliates and on their need to be controlled. In terms of the group characteristics, I controlled for group size, group age, group performance, and group growth.

### 3.3. Analytical approach

The structure of the data in this study is cross-sectional. The hypotheses were tested in different models using ordinary least squares (OLS) regressions. In each model, the control variables were entered into the regression analysis. The highest VIF was 2.35, well below the cut-off value of 10.0 for all models suggested in the literature (Hair, Anderson, Tatham, & Black, 1998). The results suggest that multicollinearity was not a problem in the regression results.

## 4. Results

Table 1 presents the means and standard deviations of the core variables in the models and the correlations among the variables. The results indicate that the means of the slack, product similarities, human capital, and shares held by the business-group headquarters calculated from the full dataset are 1.03, 0.70, 0.58, and 0.68, respectively.

Table 2 presents the regression results of the equity stakes held by the business-group headquarters in the group-affiliated firms as the dependent variable. Model 1 represents the base model, which includes only the control variables. Model 2 includes the three independent variables. The *F*-statistics for the two models indicate statistical significance ( $F = 16.22, p < 0.001$ ;  $F = 17.85, p < 0.001$ ). The adjusted  $R^2$  for Model 1, which includes the control variables, is 0.36. The addition of the main effects of slack, production similarities, and human capital in Model 2 significantly increases the explanatory power of the regression model over Model 1 (adjusted  $R^2$  change = 0.26;  $p < 0.01$ ).

Model 2 shows that the shareholding of the group headquarters decreases significantly for group-affiliated firms that have sufficient slack resources ( $\beta = -0.590, p < 0.001$ ). This result suggests that slack resources clearly enable organizations to divert attention from “fire-fighting” to risky, innovative ventures that may result in potentially high payoffs. Group-affiliated firms that operate in the Chinese market and that have large slack resources are less dependent on their business-group headquarters. Therefore, our results support Hypothesis 1, which proposes that having slack resources is conducive to managerial independence. The results indicate that the coefficient for product similarities is negative and statistically significant ( $\beta = -0.168, p < 0.05$ ), providing empirical support for Hypothesis 2. This suggests that group-affiliated firms that operate in the Chinese market can reduce their dependence on the business-group headquarters by having prior product experience. The coefficient associated with human capital is negatively significant, indicating that, consistent with our expectations, human capital influences the degree of autonomy of group-affiliated firms ( $\beta = -0.291, p < 0.05$ ). Thus, Hypothesis 3 is also supported.

<sup>3</sup> The “Southern Coast” refers to Guangdong, Fujian, Guangxi, and Hainan provinces; the “Central Coast” refers to Shanghai municipality and to Jiangsu and Zhejiang provinces; the “Northern Coast” refers to Beijing and Tianjin municipalities and to Hebei and Shandong provinces.

## 5. Discussion

### 5.1. Theoretical contributions

Theoretically, most studies of international business rely on a transaction-cost economics (TCE) approach to examine equity ownership. This approach has been criticized for its strong focus on rationality (Granovetter, 1985), for being static, and for neglecting the dynamic aspects of transactions (Ghoshal & Moran, 1996; Lewin, Weigelt, & Emery, 2004). The RDT approach assumes that all exchange actors have discretion to manage their interdependence so as to reduce the constraints of their dependence on suppliers for vital resources. Business groups are similar to an organization where there is a powerful parent company, or a “core” company, that is surrounded by offspring or descendant organizations – group affiliates or member firms – in which the parent company holds a controlling share, dominant ownership, or a dominant social position (Yiu, Lu, Bruton, & Hoskisson, 2007). But due to the considerable size of many business groups and the bounded rationality of their management teams, we cannot assume that the headquarters is fully in control of all decisions or that the business affiliates are a collection of legally independent firms (Khanna & Rivkin, 2001; Leff, 1978). In such a situation, affiliates are semi-autonomous entities that have some discretion over their activities. Group affiliates are strongly influenced by the headquarters, but they can also establish their own strategic priorities and they have the ability to influence the scope of their own operations due to their possession of valuable resources. The business-group headquarters’ equity ownership of their affiliates is indicative of a resource-dependence relationship. When the business-group headquarters holds more equity stakes in the group-affiliated firms, the group-affiliated firms will be more dependent strategically on the business-group headquarters for implementation of their own strategies and for the achievement of their own performance goals. Thus, the RDT approach provides a unique lens to study why there are differences among the equity stakes in group-affiliated firms held by business-group headquarters.

In addition, although the resource-dependence view of international business provides a fine-grained analysis of the ownership relationship in the equity stakes of the business-group headquarters in group-affiliated firms, the omission of an institutional perspective is problematic, since in an emerging-economy context, resources are constrained and the institutional environment is less structured than that in a mature economy. In this study, I adopt a multi-theoretical approach, integrating the RDT and institution-based views, to examine when group-affiliated firms operate in an underdeveloped institutional context, such as the Chinese emerging-economy market where it is difficult to follow “the rules of the game” for operations when the resources and experiences of the affiliated firms are insufficient and when the dependence of the affiliated firms on the business-group headquarters has increased significantly. Together with the empirical evidence gathered from a dataset that describes business groups according to the outward foreign direct investment activities of Taiwanese group-affiliated firms in China, this allows us to systematically investigate the extent to which the RDT logic predicts the equity stakes held by the business-group headquarters in group-affiliated firms.

Of particular interest are the findings related to Strange, Filatotchev, Buck and Wright (2009), who note that greater attention should be paid to the role of corporate governance in international business research. The reasons for this is that economic and institutional transitions increase the complexity of transactions and affect the ways in which managers process information when developing a corporate strategy

**Table 1**  
 Descriptive statistic and correlations.

Variable	Mean	S.D.	1	2	3	4	5	6	7	8	9	10	11	12	13
1. BGHO	0.68	0.38	1.00												
2. Age	12.05	3.78	0.08	1.00											
3. Size	7.96	0.76	0.12	0.03	1.00										
4. International experience	0.61	2.43	-0.33	-0.01	-0.04	1.00									
5. Performance	2.15	7.52	0.09	0.04	0.07	-0.03	1.00								
6. Location	1.78	0.86	0.06	0.04	-0.03	0.02	-0.04	1.00							
7. BG age	35.53	12.11	0.22	0.97	-0.01	0.01	0.15	0.02	1.00						
8. BG size	10.43	0.56	0.19	0.74	0.12	-0.02	-0.19	0.01	0.15	1.00					
9. BG performance	0.14	0.08	0.02	0.09	0.81	0.04	0.50	-0.04	-0.03	0.06	1.00				
10. BG growth	0.11	0.24	0.14	0.81	0.43	0.06	0.28	0.06	-0.02	0.10	0.26	1.00			
11. Slack	1.03	2.10	-0.08	0.02	0.06	-0.04	-0.08	-0.01	0.03	0.13	-0.15	0.03	1.00		
12. Similarity	0.70	0.41	-0.06	-0.06	0.02	-0.02	0.01	0.02	0.10	-0.09	0.05	0.17	-0.04	1.00	
13. Human capital	0.51	0.40	-0.19	-0.03	0.08	-0.16	-0.06	0.01	-0.11	0.43	0.48	0.22	-0.13	-0.11	1.00

Notes: (1) Two-tailed Pearson correlation coefficients are reported (2) number of observations = 1015 (3) correlations whose absolute value exceeds 0.05 are significantly different from zero at the 5% level of significance (4) dummies for industry and year is included but not presented in the table.

(Hoskisson, Eden, Lau, & Wright, 2000), especially in transition economies. Given that internationalization is an important determinant of the complexity of transactions (Sander & Carpenter, 1998), managers must expend more resources to plan and implement expansion projects. Without effective governance, an organization will not allocate resources efficiently nor will it introduce effective retrenchment or restructuring of resources. Among corporate governance mechanisms, the equity share is a critical component of every organization (Yan & Gray, 2001). The reason for this is that the equity share of group-affiliated firms is an important factor influencing their resource base vis-à-vis their headquarters. When the equity stake held by the business-group headquarters in group-affiliated firms is high, the group-affiliated firm is dependent upon its headquarters for resources; the headquarters will thus have substantial control power. This implies that the equity ownership in the group-affiliated firms of business-group headquarters provides the latter with a platform

to manage their resource-dependence relationship with the group-affiliated firm.

Empirically, even though the developed countries – that is, the European Union, the United States, and Japan – supply 90% of global foreign direct investment and China is the second-largest FDI recipient in the world, most FDI flowing to China originates in Taiwan and Hong Kong rather than in the developed countries. Nevertheless, practitioners and scholars know little about why business-group headquarters hold different equity stakes in Chinese affiliates. Various factors related to the group-affiliated firms will typically result in different levels of dependence on the business-group headquarters. The current empirical study of 2184 observations belonging to 253 business groups in Taiwan advances our understanding of this poorly researched topic. Specifically, I have drawn on the resource-dependence perspective to strengthen our understanding of the relationships between specific factors related to group-affiliated firms, including slack

**Table 2**  
 Results of OLS regression analyses for groups-headquarter shareholding level.<sup>a</sup>

Variables	Model 1		Model 2	
<b>Control variables</b>				
Age	0.058	(0.041)	0.061	(0.040)
Size	0.421	(0.047)***	0.479	(0.047)***
Performance	0.046	(0.049)	0.046	(0.048)
International experience	0.186	(0.064)**	0.191	(0.063)**
Location	0.045	(0.067)	0.046	(0.065)
BG age	0.247	(0.066)**	0.263	(0.084)**
BG size	-0.169	(0.085)*	-0.171	(0.086)*
BG performance	-0.088	(0.046)*	-0.096	(0.040)*
BG growth	0.106	(0.061)	0.094	(0.059)
Year dummy 2005	0.040	(0.033)	0.042	(0.033)
Year dummy 2006	0.091	(0.050)*	0.095	(0.052)*
Year dummy 2007	0.116	(0.043)**	0.120	(0.044)**
Year dummy 2008	0.024	(0.037)	0.024	(0.037)
Year dummy 2009	0.338	(0.036)***	0.341	(0.031)***
Year dummy 2010	0.037	(0.051)	0.037	(0.051)
Year dummy 2011	0.196	(0.042)***	0.180	(0.040)***
<b>Main effects</b>				
H1: Slack			-0.590	(0.065)***
H2: Production similarity			-0.168	(0.062)*
H3: Human capital			-0.291	(0.083)**
F-statistic	16.22***		17.85***	
Adjusted R <sup>2</sup>	0.36		0.62	
Adjusted R <sup>2</sup> Change in Model			0.26**	

<sup>a</sup> Number of observations = 1015; regression parameter appears the standardized coefficient and the standard error (in parentheses).

\*  $p < 0.05$ , two-tailed test.

\*\*  $p < 0.01$ , two-tailed test.

\*\*\*  $p < 0.001$ , two-tailed test.

resources, product similarities, and directorship ties, and the equity stakes held by the business-group headquarters.

### 5.2. Managerial implications

The findings from this research have significant relevance for managers of both group-affiliated firms and business-group headquarters. Business-group leaders should pay careful attention to balancing the dependency relationship between group-affiliated firms and the business-group headquarters. From the perspective of the group-affiliated firms, compared with their stand-alone counterparts, the affiliated firms are more likely to have certain advantages when selling to international markets because of the possession of direct ties among affiliated firms, established relationships with clients, and the reputation of the group (Guillén, 2002). But managers of group-affiliated firms are also advised to develop certain factors when entering foreign markets because these factors may have an indirect impact on their relationship with the business-group headquarters. For example, group-affiliated firms should have access to sufficient organizational slack and should build their human capital. Organizational slack not only is essential for the effective implementation of international-business opportunities, but it also serves as an effective buffer that allows firms to adjust to unanticipated foreign shocks. Moreover, group-affiliated firms must effectively manage slack resources (Mahoney, 1995). Management of slack resources tends to confer upon a firm greater prowess to plan ahead and to proceed along the scheduled trajectory of international development with fewer untoward interruptions, giving the group-affiliated firm more confidence in accelerating its entry into new areas in the Chinese market and then to create its own strategic priorities. Therefore, an increase in the resource slack of a group-affiliated firm will decrease its dependence on the business-group headquarters. In other words, the position of an affiliate firm within the business group may be affected if the affiliate possesses and effectively manages slack resources. Finally, just as an independent affiliate may be strategically important for the business-group headquarters, a dependent affiliate may also be strategically important and valuable for the business-group headquarters. This will result in the dependency relationship between the group-affiliated firm and its headquarters shifting in the direction of the affiliate company.

From the perspective of the business-group headquarters, business groups are provided with a number of stimuli that motivate them to undertake FDI by building wholly owned subsidiaries. For example, business groups may use their strong political and bureaucratic ties, which will assist them in terms of protecting property rights and enforcing contracts more efficiently than individual firms (Mahmood & Mitchell, 2004). Thus, in recent years, there has been a surge in the internationalization activities of business groups in the emerging markets: examples include Samsung and LG in South Korea, Haier in China, Tata in India, and Arçelik-Beko in Turkey. Although internationalization offers some benefits, including economies of scope and scale (Lu & Beamish, 2004), growth opportunities (Hitt, Hoskisson, & Kim, 1997), and market power (Lu & Beamish, 2004), a key challenge is how the business-group headquarters can achieve a dependency balance between the group-affiliated firms and the business-group headquarters. The group-affiliated firms may look for ways to enhance their bargaining power within the business groups, for example by increasing their control of strategic resources upon which others rely or by having an effect on other parts of the corporate network. In addition, when the headquarters develops group-affiliated firms, the size and age of the group-affiliated firms become larger and older over time; at that point, the managers of such firms, because of their abundant resources, will not

necessarily be highly dependent on their headquarters. In contrast, after the group-affiliated firms reach a certain size, the headquarters will be strategically dependent on the subsidiaries to implement its strategies and to achieve its performance goals (Peng & Beamish, 2014). The reason for this is that the size of the group-affiliated firms reflects their abilities, such as their technological sophistication (Brock, Shenkar, Shoham, & Siscovick, 2008). There is scope for managers of larger group-affiliated firms to develop broader or more ambitious goals. The goal of group-affiliated firms is to meet the expectations of the headquarters, and when it is in a start-up mode, this is the only thing that matters (Amos, Andersson, & Birkinshaw, 2010). In such a case, the headquarters is less likely to be controlled by the group-affiliated firms. Thus it is important that the headquarters adopt control strategy that balances the dependency relationship between the group-affiliated firms and the business-group headquarters.

The headquarters does not rely solely on its formal authority to balance the dependency relationship (Ahlstrom, Lamond, & Ding, 2009). A balance is also been achieved through a combination of formal direct procedures (e.g., budgets and capital investment reviews) and informal means of influence (e.g., placing expatriate staff in key positions, and establishing regional boards and incentive systems) (Gaur, Delios, & Singh, 2007; Goerzen & Beamish, 2007; Belderbos & Heijltjes, 2005). In other words, the headquarters will seek to legitimize the decisions by the group-affiliated firms so that such initiatives are included in the business-group priorities. Taken together, business-group headquarters not only need to support the development of group-affiliated firms, but also to take conscious actions to manage the group-affiliated firms.

### 5.3. Limitations and directions for future research

The limitations of this study should be further fine-tuned in future research (Ahlstrom, Bruton, & Zhao, 2013; Ahlstrom, 2015). First, the secondary data do not allow for the inclusion of data on small and medium-sized business groups; thus, the implications of the study may be limited to large business groups. Further research is needed to examine whether the associations revealed in this study are also rigorously applicable to small and medium-sized business groups. Second, this study shows that group-affiliated firms incur a resource dependency when they are operating in China, but the headquarters strategy is not directly taken into account when it decides to expand into the China market. Future research should examine whether elements of the business group's internationalization, such as its global standardization and localization, exert a moderating effect on the relationship between the characteristics of the group-affiliated firms and the equity stake held by the group headquarters. Third, the internationalization strategies may vary across entry modes, ranging from alliances and mergers and acquisitions to FDI. Different entry modes will influence the extent to which group-affiliated firms must acquire resources from other organizations. For example, compared to wholly owned subsidiaries, joint ventures with local firms allow foreign investors to better adapt to the host country, as the local partner can provide valuable help for dealing with the local environment and the local stakeholders (Hennart, Kim, & Zeng, 1998). Thus joint ventures will render the group-affiliated firms less dependent on the business-group headquarters. Future inquiries will enrich our knowledge and understanding of business-group choices regarding foreign-entry strategies (Abrahamson, 2008). Fourth, this study only compared the equity stakes held by the business-group headquarters in group-affiliated firms with and without human capital. Researchers could discern whether there will be differences between the group-affiliated firms with higher ratio of human capital and with lower ratio.

Future study may provide a more in-depth discussion by using the time span of Chinese managerial market experience.

## 6. Conclusion

The FDI strategies of firms in one of the Asian NIEs (i.e., Taiwan) with respect to a rapidly emerging market (i.e., China) are now a major field of study in international business. Many earlier studies focused only on the FDI strategies of firms in the advanced economies that were investing either in other advanced economies or in the emerging economies; only recently have scholars begun to explore this more recent phenomenon. Based on resource-dependence theory and an institutional perspective, the present study points to a new avenue for research on the ownership relationship between Taiwanese business-group headquarters and group-affiliated firms in China's large emerging economy. Thus this study has both practical and theoretical implications with respect to the key activity of FDI and emerging economies.

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## Appendix A

Table A1.

Table A1

Editions of directories put out by China Credit Information Service (CCIS) as compared with pertinent fiscal years.

Editions of CCIS directories	Corresponding fiscal year
2012	2011
2011	2010
2010	2009
2009	2008
2008 (updated)	2007
2008	2006
2007	2005
2006	2004

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