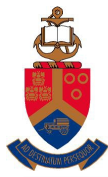

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Strategic responses of subsidiaries of multinational firms in emerging markets to institutional Pressures: shedding light on the liability of foreignness

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A research project submitted to the Gordon Institute of Business Science, University of Pretoria, in partial fulfilment of the requirements for the degree of Master of Business Administration.

11 November 2013

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Abstract

Institutional theory has been used to explain the duality of multinational companies and the need to establish legitimacy both internally- within the organisation and externally-with the external operating environment. The concept of liability of foreignness explains the legitimacy pressures posed by the duality of environments that MNCs are exposed to and the strategic responses taken in this context. However it remains unclear how MNCs respond appropriately to the conundrum, more so in the emerging market context.

Using deductive qualitative research grounded on institutional theory, the research study sought to establish which liability of foreignness issues posed the greatest challenge for MNC executives in emerging markets, their response to emergent issues and additionally how they deal with conflicting outcomes, if any from the strategic responses taken. The findings support institutional theory precepts that external institutional pressures pose the greatest challenge for MNCs but conversely the firm's response to the challenges puts the overall efficiency of the firm at risk.

Executives of MNCs focused on emerging markets will find the outcome of the research useful as it identifies key LOF issues and the appropriate strategic response. More importantly it also addresses albeit to a limited extent how to mitigate the conflicting outcomes of such actions. An attempt is also made at establishing an optimal mix of strategic actions.

Key words

Institutional pressures, liability of foreignness, relational hazards, network and partnerships

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Declaration

I declare that this research project is my own work. It is submitted in partial fulfilment of the requirements for the degree of Master of Business Administration at the Gordon Institute of Business Science, University of Pretoria. It has not been submitted before for any degree or examination in any other University. I further declare that I have obtained the necessary authorisation and consent to carry out this research.

Grace Murage

11th November 2013

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Acknowledgements

I would like to acknowledge the following people for making such a significant and invaluable contribution to helping me complete this research:

Prof Albert Wocke: my supervisor, for your guidance and insight in putting this research together

Job Kabochi: for serendipitously synchronising your travels with the immense deadlines and running with the wedding plans. Look forward to the rest of our lives together.

Mueni Muendo: A true friend indeed. Thank you for all your timely and invaluable assistance.

My trusted MBA colleagues: your camaraderie is unrivalled. Thank you for the late commiserating sessions.

The interviewees: For being such good sports and sparing your time in the name of academics

Finally, this research work would not have been complete without the one and only Trusted Advisor- my heavenly Father. Thank you for getting me across the line!

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Strategic responses of subsidiaries of multinational firms in emerging markets to Institutional Pressures: shedding light on the liability of foreignness

1. Introduction

1.1. Institutional view of the firm

The magnitude and reach of multinational corporations (MNCs) has grown exponentially over the past few decades. In 2003, it was reported that there were 63,000 multinationals across the globe compared to just three thousand in 1990 (Gabel and Bruner, 2003).

In UNCTAD's World Investment Report of 2012, nine of the top 50 financial multinational corporations ranked by geographic spread were of American origin. Collectively these nine banks had $22 Billion in total assets, with over 1,900 foreign affiliates, employing a total of $1.3 million people (UNCTAD, 2012). The size and global footprint of American banks coupled with the continuing regulatory reforms they are faced with, presents the opportunity to explore how these home-country changes impact the operations of their foreign subsidiaries to the extent of building legitimacy and overall subsidiary performance

Due to the global reach, MNCs are faced with a duality of environments (Kostova and Zaheer, 1999) presents pressures to obtain both internal and external legitimacy. The need to establish this legitimacy presents a liability of foreignness for MNC subsidiaries (Zaheer, 1995). LOF is observed to be wide spread in emerging economies and in banking especially (Zaheer, 1999; Miller and Parkhe, 2002; and Lou and Mezias, 2002) due to the transitioning and dynamic nature of such economies.

Within the field of international business, institutional theory posits that multinational firms face both formal and informal institutions which influence their business activities (Peng and Chen, 2011). Several authors (Meyer et al. 2009, Peng 2003, Peng et al. 2008; Peng et al. 2009; Scott 2001) have asserted these institutions form the rules of the game which multinational corporations need to adhere to in order to retain legitimacy. These home-country and host-country institutions present unique challenges and opportunities to which multinational firms need to strategically respond (Peng and Chen, 2011)

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1.2. Problem Definition and Purpose

Today, nowhere are these institutional factors more alive and in transition that in the global banking industry. Regulatory and legal complexities are some of the issues facing MNCs in emerging economies

KPMG's 2013 Banking Regulation Report asserts that the banking industry continues to reel from effects of the global financial crisis and as a result finds itself at a point of inflection, where change is inevitable (KPMG, 2013). It is on this premise that a variety of new regulations has been enacted to remedy the effect of the global financial crisis.

Not only is the global banking sector having to deal with regulatory reforms, it also is facing conflicting demands from the various stakeholders: regulators seeking prudence, customers looking for lower banking costs and shareholders in search of returns and dividends. These represent the nature of the home-country institutional pressures this research will be focusing on in terms of their impact on foreign subsidiaries of US multinational banks.

1.2.1. Regulatory Reforms facing the Global Banking Industry

Following the global financial crisis, policy makers both at global and national levels have put together an onslaught of regulatory reforms crafted along nine pillars (KPMG, 2010). The nine pillars are identified as:

- Capital
- liquidity
- systemic risk
- Supervision
- Accounting disclosure
- governance
- Remuneration
- Customer treatment
- Traded markets

Of relevance to this research are the regulatory pillars on capital, liquidity and systemic risk. Below is a brief discussion on the changes introduced under these pillars.

i. Capital and Liquidity

Basel III Requirements as issued by the Basel Committee called for banks to hold greater capital reserves to absorb financial risks. Higher capital buffers imply pressure on the cost and availability of bank's lending activities, a primary source of income for banks.

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The Basel III Requirements presents both challenges and opportunities for the US banks as outlined in KPMG's most recent report on banking regulatory reforms in the America's (KPMG, 2013). Key among these challenges is the choice of what businesses to be in and which to exit from, rising cost of compliance and regulatory uncertainty.

ii. Supervision

The Dodd-Frank Act creates multiple new regulatory agencies adding to the existing complex regulatory framework in the US. Of special note is the creation of the Financial Stability Oversight Council (FSOC) which will undertake macro-supervision in the US. This means, in addition to the existing regulatory oversight bodies such as the Federal Reserve and the Office of the Comptroller of Capital, US banks will be subject to an additional supervisory body. This implies additional regulations and incremental costs to comply with the new regulatory stance.

1.2.2. Red-tape America:

Not only are US banks in a state of flux and dynamic change, the US as a geographical location also finds itself in such a situation. It has been argued that American companies are by far the most regulated entities the world over. The Economist published an article to this effect (Economist, 2012) citing that America is the country most riddled with red tape and complex laws. This complexity arises from two factors: the innate need to govern any eventuality and lobbyists' actions arising from governments drive to micromanage all activities.

1.3. Research Scope

In UNCTAD's World Investment Report of 2012, nine of the top 50 financial multinational corporations ranked by geographic spread were of American origin. Collectively these nine banks had $22 Billion in total assets, with over 1,900 foreign affiliates, employing a total of $1.3 million people (UNCTAD, 2012). The size and global footprint of American banks coupled with the continuing regulatory reforms they are faced with, presents the opportunity to explore how these institutional pressures impact the operations of their foreign subsidiaries to the extent of building legitimacy and overall subsidiary performance.

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1.4. Research objectives

Responding to Denk, Kaufmann and, Roesch (2012) call for further research to be doing in the area of LOF, the following research objectives are envisaged:

- Establish which drivers of LOF present to the greatest cost to the MNC in comparison to other drivers of LOF
- Identify appropriateness of actions to address the drivers of LOF
- Establish how MNCs can assess the mitigating and/or aggravating outcomes of pursuing a particular action.

1.1. Relevance to business:

Luo, Shenkar and Nyaw (2002) assert that emerging markets are unique as compared to industrialised or developing economies because of the transitional nature of their industrial and institutional environment. This transition is not only a source of market opportunities for investors but also poses numerous challenges and uncertainties for business operations. Findings from the research may provide MNCs with an ability to better understand and anticipate how and why subsidiary performance will vary across countries. A recent study conducted by IBM, suggesting that by the year 2050 roughly seven-eighths of the world's population will be living in emerging economies such as China, India, Russia, Mexico, Brazil, and so forth (IBM, 2008).

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2. Literature Review

2.1. Introduction

The literature review covers extant research on liability of foreignness (LOF) against the context of international business. The chapter uses institutional theory to identify the 'rules of the game' the multinational company must contend with and highlights the duality of environment posing a need to establish legitimacy internally and externally. It is the legitimising process that causes the MNC to face LOF. It will be demonstrated that while there abounds literature on the various sources, consequences and mitigating actions MNCs take in response to LOF, there still remains gaps on the relative importance of the source (hazards) of LOFs, appropriateness of mitigating actions to LOFs and a lingering question as to whether there exists an optimal mix of strategies for the MNC.

2.2. The institutional view of the firm

Within strategic management literature, two perspectives have been positioned in explaining strategy formulation for MNCs:

The first; industry based view (IBV), was advanced by Michael Porter (1980) and states that conditions within an industry, to a large extent, determine firm strategy and performance (Peng, Wang and Jiang, 2008)

The second was the resource based view (RBV) of the firm proposed by Barney (1991) which suggests that a firm's strategy and performance are driven by firm specific differences and not industry factors (Peng et al., 2008).

With the emergence of developing economies, the IBV and RBV were found to be lacking in explaining the role of institutions in formulating the MNC's strategy. This follows various observations (Kogut, 2005; Wright, Filatotchev, Hoskisson, and Peng, 2005) that emerging market firms faced resource scarcities and obsolescence across different environments hence implying that factors outside of the industry and firm specific resources as posited by IBV and RBV, played a role in the MNC's strategy formulation.

Zhou and Li (2007) posit the importance of institutions, stating that institutional factors such as laws, regulations, and norms should be treated as independent variables rather than background conditions in research on emerging economies.

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Emerging economies are defined by Hoskisson, Eden, Lau and Wright (2000) as one characterised by a rapid pace of economic development and government policies facing economic liberalisation and the adoption of a free market.

Peng et al. (2008) assert that the IBV and RBV treatment of institutions as background factors - hence failing to adequately explain MNC strategy in emerging markets was based on the fact that previous research had focused on stable (developed) markets such as the United States. Hence emerging economies - which are in a rapid economic liberalisation would not suit the profile of the firms used in the empirical research of IBV and RBV.

2.2.1. The emergence of the institutional view of the firm

The central tenet of institutional theory is that organizations within a particular environment tend to conform to institutional norms and values to gain legitimacy in the eyes of other players within the same operating environment (DiMaggio and Powell, 1983; North 1990; Scott 1987; 1995; 2008).

North (1990), building on the metaphor of 'rules of the game' defined institutions as comprising formal constraints such as laws and regulations as well as informal constraints such as norms, customs and culture. North (1994) later pointed out that these constraints were devised to structure human interaction, and comprised not only formal and informal constraints but also their enforcement characteristics. A view that was much later supported by Nelson and Sampat (2001) who viewed institutions as patterns of human interaction that relate to the division of labour and the mode of coordination of human activity - leading to the rise of social technology.

Scott (1995) viewed institutions as the regulative, normative, and cognitive structures and activities that provide stability and meaning to social behaviour.

Peng (2002) acknowledged that the MNC was exposed to a variety of institutions and should therefore not be deemed as dormant stakeholders but instead treated as playing an active role in the formulation of the MNC's strategy.

Makino, Isobe and Chan (2004) posit that foreign subsidiaries face two sets of institutional pressures: external institutional pressures to conform to local demands in the home country, and internal pressures imposed by the parent firm to sustain consistency.

Wan (2005) viewed institutions in a positive light; as tools for influencing the strategic development of firm-specific resources and the likelihood of success of different

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corporate strategies. While Wright *et al.* (2005) provided a structure with which to view institutions - as three pillars: political, social and economic systems; which shape the firm's behaviour.

More recently Peng and Chen (2011) have expounded on the institution based view of the firm, stating that it comprises both formal and informal institutions which dictate the rules of the game that firms need to follow in order to retain legitimacy.

2.2.2. Institution theory in international business

The relevance of institutional theory in international business arises from the inherent need of the firm to establish and retain legitimacy within its operating environment. The concept of legitimacy was initially addressed by Zaheer and Mosakowski (1997); and Kostova and Zaheer (1999) who asserted that foreign firms face a duality of environments - the global and the local operating environment. Defining legitimacy as the "acceptance of the organisation by its environment", the authors assert that the duality of environments calls for an establishment and maintenance of both internal and external legitimacy if the firms are to remain successful.

Internal legitimacy, they argue, refers to the approval of a subsidiary by the parent company and results from it adopting practices which are institutionalized within the multinational firm and shaped by the home country environment of the parent company. External legitimacy is awarded by the institutional environment in which the subsidiary is embedded and stems from it adopting practices institutionalized in that environment.

Smidt (2009) asserts that foreign firms lack roots and legitimacy in the host country which in turn limits the opportunities for foreign MNC. This lack of legitimacy stems predominantly from a lack of access to the knowledge of host country customers when foreign MNC subsidiaries have to compete for this access with leading host country rivals.

The process of legitimisation is social and cognitive in nature, hence 'complex, imperfect and boundedly rational, especially for the MNC where both the organization and the legitimating environment may lack the information necessary to correctly understand, interpret, and evaluate each other (Kostova and Zaheer, 1999; Peng et al., 2008; Koene and Ansari, 2011; Peng and Cheng, 2011). This complexity leads to the phenomenon of liability of foreignness (LOF) for the MNC which is explored below.

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2.3. Liability of foreignness defined

LOF traces its origins to Stephen Hymer (1976) who proposed that firms setting up operations overseas face costs that firms otherwise operating locally do not. He termed this phenomenon as the 'cost of doing business overseas', positing that it is driven by the fact that local firms have better access to relevant market information, are more deeply embedded in the national environment and therefore do not face foreign exchange risks.

Zaheer (1995) later refined the concept; introducing the phenomenon of 'liability of foreignness' which he defined as the costs of doing business abroad that result in a competitive disadvantage for the multinational corporation's sub-units. The costs represent the challenges arising from external and internal stimulants (institutions) that are culturally different from the firm's home country environment. LOF should be viewed as being relative to what the local firm might experience (Zaheer, 2002).

More recently, Eden and Miller (2004) have defined LOF as the additional tacit and social costs that foreign firms face when entering a particular host market that are not incurred by well-embedded indigenous companies. This implies that the associated costs of LOF might comprise implied costs such as opportunity costs.

2.4. Sources of Liability of Foreignness

Zaheer (1995) was the first to explore the components of LOF and identified four sources viewed in the context of the related costs as regards: spatial distance between the MNC and its operations, unfamiliarly with the local culture, economic nationalism and home country nuances such as trade restrictions.

Similar to Zaheer, Dunning (1995) in using the context of distance, identified four major costs: spatial distance (e.g., transportation cost), cultural distance (e.g., adaptation cost), and institutional distance (e.g., costs for organizational legitimacy).

Zaheer and Mosakowski (1997) add that in addition to the above sources, LOF arises from lack of information networks or political influences in the host country. The duo also highlight that the contributing factors can be grouped into two: those that change over time and those that do not. Examples of the former include, for instance the managers of the foreign firm may be able to acquire an understanding of the local culture and hence align their external and internal business practices to the demands of the local labour market or customer base. Other factors, however such as economic

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nationalism - where governments for instance prefer to purchase from local firms exclusively, may not change at all.

Similar to Zaheer (1995), Matsuo (2000), argued that liabilities of foreignness stem from three major sources: culture and language differences, economic and political regulations, and spatial difference between parent and subsidiary.

LOF arising from culture was explored by Calhourn (2002) who argued that cultural variations exist not just in the external but also internal environment of the firm. These variations present an information asymmetry for foreign firms that impede their strategy implementation especially when they fail to grasp their manifestation.

Cultural differences in the external environment of the firm arise from a myriad of undocumented market nuances and practices coupled with varying levels of transparency in Government's institutional practices and procedures. This is exacerbated in less transparent markets such as those in emerging economics, as displayed by increased levels of corruption which result in higher institutional efficiency. Within the internal environment, cultural differences arise from observable behavioural differences as well as less observable value differences of individuals (Eden and Miller, 2004).

Mezias (2002) provides two additional sources of liabilities of foreignness. The first source is from costs that are not exclusive to foreign firms. Mezias argues that some significant operating costs affect both foreign and domestic firms, but foreign firms may experience these costs disproportionately because domestic firms have learned to mitigate these costs. An example of this is lawsuits. The second source is from expanding the view of LOF to also include advantages that domestic firms enjoy that are not accessible to foreign firms. An example of this is the ineligibility of foreign firms to tender for government contracts which are left to the precursor of domestic firms.

Building on these additional sources, Mezias (2002) provides a revised definition of LOF to read: "Liabilities of foreignness are costs only foreign firms incur when operating abroad, costs foreign firms incur disproportionately to domestic firms, and benefits denied to foreign firms that are enjoyed exclusively by domestic firms".

Sethi and Guisinger (2002) extend the concept of LOF, positing that it not only emanates from a lack of understanding of the local operating environment but also by not formulating and implementing a strategy that is compatible with the environment.

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These costs are not only present at the time of entry into a foreign market but may persist throughout the life of the foreign firm within the local market.

Rangan and Drummond (2004) argue that LOF is also impacted by home and host country relations. They find that the MNC whose home country has greater ties to the host country as defined by geographic, colonial, immigration and institutional dimensions will lead in that host nation.

Rangan and Dummond's work is supported by Moeller, Harvey, Griffith and Richey (2013) who explored the impact of the country of origin on the acceptance of a foreign firm in a host country as it bears on the organisational identity. The country of origin is a badge by which locals view the foreign firm as it represents the background/history of the organization to host country constituents. Country of origin can be a favourable signal to residents of the host country, but at the same time, the image of the company may be tarnished by the past acts of the organization or by the country-of-origin of the organization.

2.4.1. Conceptual framework for liability of foreignness

The preceding discussion affirms that academics (Zaheer,1995; Zaheer and Mosakowski, 1997; Matsuo, 2002; Mezias, 2002) are aligned on what drives LOF, citing factors such as unfamiliarity with the culture and local language, spatial distance between the parent and subsidiary and host country discrimination for instance in the form of economic nationalism. While there is alignment on the source of liability of foreignness, two issues emerge - one the difference between LOF and cost of doing business - are the two terms interchangeable? Secondly - the need to have a conceptual framework to better categorise the drivers of liability of foreignness.

Eden and Miller (2001) provide some guidance on both these issues. One - they distil the cost of doing business abroad slightly differently, into various components such as relative production costs, managing operations at a distance - including set-up, governance and exit costs. More focal to this study, they categorised LOF into two sub-sets:

i. Unfamiliarity hazards: this is the lack of knowledge of the host country market. Herein - Eden and Miller introduce a new concept of liability of newness- which is measured by the costs that the multinational company must incur to achieve the same level of knowledge as local firms. The pair breaks down the unfamiliarity hazards into two: newness to the country and to the industry

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ii. Discrimination hazards: this is the differential treatment of the foreign firm relative to the local firm. It could arise from differential treatment by the home or host governments, consumers or suppliers in the host country.

Balabanis, Diamantopoulos, Dentiste Mueller and Melewar (2001) outline consumer ethnocentricity in the host location as a form of discrimination hazard while Henisz and Williamson (2005) outline that discrimination hazards encompass political hazards where the host country governments adopts a different attitude towards foreign investors.

Eden and Miller (2004) add a third categorisation: relational hazards, which arise from organisational transactional costs both internally and externally. These may arise from lack of trust or embededness in the local environment, manifesting in the buyer-supplier-competitor network. Eden and Miller's work provides a more structured framework with which to better distil the LOF.

Using this framework, the various sources of LOF can be categorised as follows:

i. Unfamiliarity hazards: lack of embeddedness in local networks (Rangan and Drummond, 2004); lack of international experience (Asmussen, Pedersen and Dhanaraj, 2009) and lack of specific institutional and host-market knowledge of the local business practices (Elango, 2009) are identified as the main sources of unfamiliarity hazards under LOF.
ii. Discrimination hazards: economic nationalism and a lack of legitimacy resulting in adverse treatment of the foreign firm by governments, customers, or the general public is identified by Newburry, Gardberg and Belkin(2006) as the main drivers.
iii. Relational hazards: Nachum (2003) asserts ownerships structures and the degree to which a foreign entity is integrated into the overall organisational structure of the home country headquarters and other subsidiaries of the parent firm as a key driver of relational hazards in LOF. Additionally Li, Poppo and Zhou (2008) cite lack of trust in the local environment as a cause of relational hazards.

2.4.2. Liability of foreignness in the financial industry

In a study of the global currency trading industry, Zaheer and Mosakowski (1997) assert that the degree of regulation in the financial services industry afforded multinational banks a less degree of freedom. This is in terms of strategic and organisational choices to compensate for their LOF as compared to local firms. The

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duo argues that foreign firms face difficulty in establishing and maintaining institutional linkages in their host country, which are important for not only establishing legitimacy but also for the valuable information they provide.

Miller and Parkhe (2002) assert that banks operating abroad face environments that are dramatically different from each other, and from the home country itself. They are therefore more likely to experience increased costs, reduced operating efficiency and profitability, and diminished competitiveness relative to host country banks.

The duo argue that banks follow their customers abroad in order to build or preserve an existing relationship, or to prevent losing a relationship to a host country firm or another MNC, not only in the local market, but on a global basis. As such foreign banks opt to compete with host country banks, rather than lose the client and therefore may be more focused less on the host country profit and more on preventing losses worldwide.

The resulting revenue inefficiencies are an important consequence of the LOF, as banks forgo revenue opportunities with potential local customers, and concentrate instead on home country clients.

Interestingly, their study confirms a U.S. home country advantage in host countries with bank-oriented financial systems, despite strong criticism of the U.S. regulatory environment by many bank executives and policy-makers. This is on the back of the continuous push by US companies to innovate. The exception to this finding is in high credit risk environments where US banks are seen to adopt a more conservative approach.

Li (2008) asserts that the LOF applies to the international banking context as well, as banks operating abroad may face environments that are dramatically different from those at home. He argues that LOF is seen more in the commercial loan segments where there is a greater requirement for local knowledge.

Bell, Filatotchevand Rasheed (2012) sought to explore LOF in capital markets, expending previous research that had focused only on the product domain. Their study argues that firms seeking to raise funds out of their home country face a home bias phenomenon among investors and hence incur additional costs. Interestingly, the sources leading to the LOF are not different from extant literary work - citing institutional distance, information costs, unfamiliarity costs, and costs arising from cultural differences as being the four major types of sources.

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2.4.3. Liability of Foreignness in Emerging Economies

Garg and Delois (2007) assert that although developed countries offer a better institutional environment, stable political conditions and legal systems, developing countries are less institutionally and culturally distant from developing countries. Developed countries are characterized by a strong institutional environment where the institutions are rule-based institutions that promote impersonal exchange (market-based transactions) while emerging markets have relation-based institutions that promote personalized exchange (Peng, 2002).

Hoskisson, et al. (2000), point out that institutional theory is one of the most useful theories to examine idiosyncrasies of transforming economies.

2.5. Consequences of Liability of Foreignness

In a study conducted by Mezais (2002) on foreign owned firms in the US, the firms were found to have more labour law suits brought to judgement than US owned fims. Mezias uses the legal environment complexities and related human resources/labour issues as a proxy for LOF. Additionally, those firms who used American top officers or whose parent firms had more US operations were found to face fewer lawsuits, while foreign subsidiaries using human resource professionals actually faced more labour lawsuit judgments.

This is consistent with Zaheer (1995) and Zaheer and Mosakowski (1997) who asserted that regardless of the source of the LOF, as a consequence, foreign firms are less profitable than local firms. This sub-optimal position arises from foreign firms using organizational practices that differ from the legitimate or locally accepted practices.

Notwithstanding this, Hennart, Roehlb and Zeng (2002) observe that research on the consequence of LOF has focused on the survival rates of foreign affiliates of MNCs, with mixed findings. The central tenet in previous research on this has been that LOF will depress profits and that this in turn will cause affiliates to exit.

While Zaheer and Mosakowski (1997) found lower survival rates for foreign firms, Mata and Portugal (2002) - studying the survival patterns of two samples of domestic and foreign-owned units operating in Portugal – failed to any differences in gross exit rates between foreign and domestic units. This is after controlling for a number of firm and

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industry characteristics such as technological intensity, unit size, and legal form at entry, parent diversification, and growth rate and concentration ratio of the industry entered by the unit.

Larimo (2000), studying the gross exit rates of more than 2,600 foreign affiliates of Danish, Finnish, Norwegian and Swedish firms in over 50 countries found that being located in a culturally distant country actually reduced the probability of gross exit; negating the tenet that LOF leads to lower survival rates (at least as measured by exits).

Hennert et al. (2002) attempt to provide some insight into this conundrum; asserting that the exits are not due to poor profitability but rather to parents restructuring their portfolios or winding down their options. They analysed the exits to 1998 of 32 Japanese-owned affiliates that manufactured in the US in 1998; a good sample to evaluate the presence of a LOF, as liquidating a manufacturing affiliate is relatively costly and the US market is a strategic one for Japan. Some of the divergent reasons for the exits were due to difficulties managing local employees, issues with the government and also some had made overoptimistic market forecasts. These are in line with previous literature on the drivers of LOF.

Kronborg and Thomsen (2009) in a study of survival of foreign and domestically owned companies in Denmark over more than a century (1985-2005) found that domestic firms had a significantly higher exit risk - almost twice that of foreign subsidiaries. This is attributed to the benefits accruing from foreign ownership such as access to capital, brands, knowledge and other resources from the parent company, which outweigh the cost of foreignness. This view is supported by Sethi and Guisinger (2002) and Zaheer and Mosakowski (1997) who asserted that MNCs do possess certain competitive advantages that do not accrue to domestic firms.

2.6. Mitigating Liability of Foreignness: Establishing local isomorphism

Establishing local isomorphism has been identified by various authors (Ahlstrom and Bruton, 2001; Luo, et al., 2002; Miller and Eden, 2006; Salomon and Wu, 2012) as one of the main ways in which foreign firms establish legitimacy in local markets.

Isomorphism is defined by Miller and Eden (2006) as the process in which foreign firms imitate elements of the strategies and business practices of local competitors. In so doing, they adopt ‘proven strategies’ that are viewed as being locally legitimate.

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They are various ways in which foreign firms pursue local isomorphism:

2.6.1. Defensive and Offensive Mechanisms

Luo, et al. (2002) introduces the concept of defensive and offensive mechanisms in establishing legitimacy. They argue that defensive mechanisms are designed to reduce an MNC's dependence on the host country resources and its interactions with complex, uncertain, or hostile environments. Offensive mechanisms on the other hand are geared towards enhancing an MNC's adaptability to environmental dynamics in a host country and elevate an MNC's organizational legitimacy as perceived by host country stakeholders. The outcome of defensive mechanisms is reducing the cost of LOF whereas offensive mechanisms improve the returns from transforming foreignness.

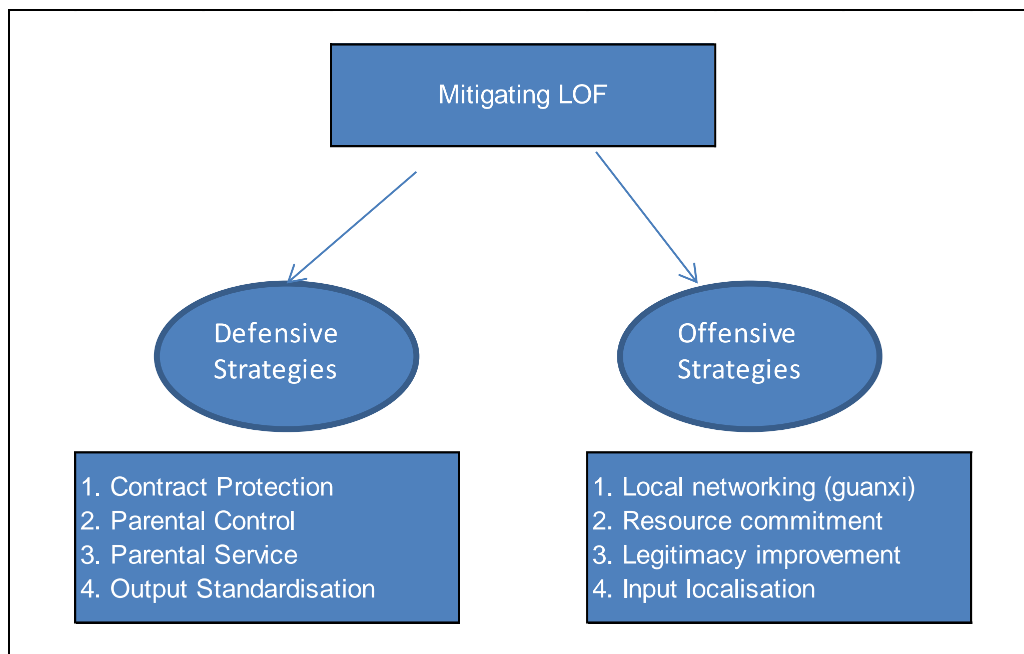

Figure 1: General mechanisms mitigating LOF; Luo et al. (2002)

Within the context of emerging economies, Luo et al. (2002) specifically highlight the establishment of contracts and networking as specific defensive and offensive mechanisms respectively that work well. Networking (or *Guanxi*) was specifically found to enable the MNC's adaptation, localization, and legitimacy. Their assertion was based on a study of 92 MNC subsidiaries operating in China - which accounts for

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almost half of the FDI to developed economies and also known for exceptional levels of LOF due to lack of government transparency; thus providing a viable research ground.

Mezias (2002) specifically highlight the importance of parental control in understanding and mitigating the LOF - especially the foreign subsidiary's ability to engage in local isomorphism. He notes that in an MNC, the parent is the dominant player and subsidiaries may not be allowed to maximise their utility especially where the goals of the subsidiary are in conflict with the overall MNC's goals. Therefore parental control should be viewed in the context of subsidiary autonomy as this helps minimise the exposure of the subsidiary to LOF. He argues that a multinational corporation's accumulated international experience helps its subsidiaries avoid common mistakes of foreignness when entering a new host country. Greater compliance with host-country norms helps minimize exposure to liabilities of foreignness.

Output standardisation is affirmed by Chirstmann and Taylor (2001) who assert that MNCs have competitive incentives to develop a standardized approach in the whole network using the headquarters' regulation which is usually more stringent. Standardisation (or unification) allows for a reduction of organisation complexity which affords the subsidiary some level of legitimacy.

2.6.2. Developing firm-specific advantages

Zaheer (1995), Eden and Molot (2002), Nachum (2003) posits that multinational firms need to develop firm-specific advantages or mimic advantages of successful local firms to overcome their LOF.

Firm-specific advantages may be derived from specific competitive advantages, for instance leveraging economies of scale, financial strength, divergent management skills technology adoption and non-hierarchical modes of control; and may prove more successful especially where the LOF emanates from organisational capabilities as allow foreign firms to become ''insiders'' or first-movers, thereby creating entry barriers for later arrivals (Eden and Molot, 2002).

Firm-specific advantages may also present themselves as different staffing strategies for the subsidiary firm (Matsuo, 2000; Mezias 2002). In a study conducted on Japanese foreign subsidiaries by Matsuo (2000), the firms were found to use more expatriates when they faced LOF whereas Mezias (2002) found that foreign subsidiaries, with host

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country nationals as their top officers, faced fewer labour lawsuit judgments - which negates the idea of local isomorphism.

Nachum (2003) specifically notes that firm-specific advantages are geographically mobile and easily transferrable within an MNC's internal network - making them quite effective in mitigating the LOF.

Conversely, Miller,Thomas, Eden and Hitt (2008) argue that the development of firm specific advantages may be better suited for firms in developed markets rather than emerging/developing economies. This is because emerging market firms face a double edged sword - the additional costs of doing business abroad coupled with resource scarcity compared to domestic firms in emerging markets. To mitigate this dual challenge, Miller et al. (2008) propose that emerging market firms draw on their "ethnic identity" either from their customers or competitors in the local market.

2.6.3. Organisational Entrepreneurship

Cantwell, Dunning and Lundan (2010) assert that MNCs are today faced by increasing uncertainties and complexities in the external environment and as such have to engage in institutional innovation to counter such uncertainty and establish legitimacy in the local environment. Such innovation is displayed in MNCs evolving decentralized governance structures, involving more locally responsive, yet internationally connected, relationship - which they term as institutional entrepreneurship.

The concept of institutional innovation or entrepreneurship stems from the assertion by previous authors such as Miller and Eden (2006) who argued that local isomorphism may be a self-defeating strategy in mitigating LOF. This is because as foreign firms adopt local strategies which are deemed legitimate, other industry players adopt similar strategies leading to increased competition which in turn increases the likelihood of failure. Earlier contributors such as, Sethi and Guisinger (2002) argued that it is not enough for MNCs to continuously monitoring their operating environment; they need to be swift in detecting changes in the environment and agile enough to adapt their internal procedures to be in sync with the environment. The duo highlighted that MNCs that consistently excel in embedding these tacit skill in their personnel and internal routines would enjoy a competitive advantage over their rivals.

Some of the areas to scan in the organisational environment; or the ''geovalent components of the environment,'' as defined by Guisinger (2001) are the economy, geography and demography (econography); culture, legal systems, income levels, political risks, tax regimes, exchange rates and restrictions.

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Organisational entrepreneurship is supported by Salomon and Wu (2012) who argue that the need to adopt isomorphic strategies diminishes as firms become more embedded in the local environment and therefore other avenues of differentiation are required to safeguard their legitimacy.

2.7. Choosing the appropriate strategy

Mezias (2002) argues that when operating in host countries with powerful institutions such as US courts, foreign subsidiaries are under greater pressure to comply with local regulations and face higher costs of noncompliance. In such circumstances, subsidiaries are better off identifying and implementing host country practices that increase their legitimacy. The concern here is that these practices are often tact, culture-based understandings which may not be easily detected or implemented by foreign managers - almost a vicious cycle.

While LOF may make acquiring and controlling of critical local resources more challenging for MNCs, not all foreign firms are entirely dependent on host country resources (Lou and Mezias, 2002).

Specifically Makino, ET al. (2004) asserts that conforming to external pressure by imitating local institutionalized practices may increase the legitimacy and the likelihood of survival of foreign affiliates. However, the duo cautions that such imitation does not necessarily make firms more efficient- it may actually limit the efficient transfer of the practices and routines on which the parent firms' strategic advantage is based from the parent firm to its foreign affiliates and hence affect the economic outcomes of their business activities.

Yildiz and Fey (2012) support this view by arguing that the LOF and the pressure to conform to local institutions may diminish where the rules of the game in the local institution are not well established or are in a state of flux, as in developing economies. As such MNCs in such markets, may pose less pressure to legitimise. Unfortunately, their assertion is nature and lacks empirical evidence to support it. This is one of the areas this research study will attempt to focus on.

Schmidt and Sofka (2009) find that where foreign subsidiaries face markets with large numbers of dispersed, heterogeneous customers, a defensive strategy may be appropriate. This would entail outsourcing early stage market research and innovation as well as marketing to local firms with established networks and procedures. On the

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other hand, if it is easier to identify, observe and evaluate local customers, foreign MNC subsidiaries should move towards active strategies. This could imply recruiting key personnel from customers or engaging in collaborations or joint development with key customers. The latter should be focused on establishing broad interfaces and personal networks between subsidiary employees and local customers to generate extensive channels for future knowledge transfer.

2.8. Summary of literature review and extant gaps

The literature review traced the emergence of institutional theory and its impact on the multinational firm (North, 1990; Scott, 1995; Nelson and Sampat, 2001; Wright et al. 2005 and Smidt (2009)). It is appreciated that the institutions, both external and internal to the MNC define the rules of the game; and this duality of environments poses a LOF for the firm (Zaheer, 1995; Zaheer and Mosakowski, 1997; Zaheer, 2000; Peng et al., 2008; Koene and Ansari, 2011; Peng and Cheng, 2011).

The relevance of LOF to the MNC was identified as accruing from the need to establish legitimacy (Zaheer, 1995; Zaheer and Mosakowski, 1997 and Smidt, 2009).

The drivers behind LOF were defined by Zaheer (1995); Matsuo (2000); Ghemawat (2001); Sethi and Guisinger (2002); Calhoun (2002); Miller and Richards (2002) as well as Rangan and Drummond (2004) to include various elements such as information asymmetry, lack of embeddedness and economic nationalisation among other factors. Eden and Miller (2001, 2004) provided a more robust conceptual framework with which to classify the various sources of LOF. The framework classifies the LOF into three: unfamiliarity, discrimination and relation hazards.

The literature review then provided various strategies using which MNCs can mitigate the LOF. Local isomorphism and development of firm specific advantages and organisational entrepreneurship emerged as the main ways in which firms deal with LOF (Ahlstrom and Bruton, 2001; Mezias, 2002; Luo et al. 2002; Nachum, 2003; Miller and Eden, 2006; Cantwell, Dunning and Lundan, 2010 and Salomon and Wu, 2012).

The choice between which strategy to employ when was however not clearly established as the various authors had differing views (Luo et al. 2002; Mezias, 2002; Christmann and Taylor, 2001, Eden and Molot, 2002; Nachum, 2003; Cantwell et al., 2010).

Some of the gaps that emerge from the literature review include:

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i. Whilst the contributions noted in the literature review have done well to demystify the 'black box' of LOF, Denk, et al. , (2012), note that there still remains a lack of understanding with regard to the relative importance and interdependencies of individual LOF hazards and their outcomes. Petersen and Pedersen (2002) allude to the unfamiliarity of the local business environment as being the key hazard by stating this is the one area that management of an entrant firm can make significant different in.

ii. Additionally, actions that multinational corporates take to address the LOF might have both mitigating effects and conflicting outcomes, which remain unclear to date. Makino, et al.'s (2004) work might provide some insight on this from an institutional perspective but no extant research has been done with LOF in mind.

iii. Yildz and Fey (2012) also notes that previous contributors to LOF (Kostova and Roth, 2003; Zaheer, 1995; Zaheer and Mosakowski, 1997) focused on developed markets as the host country for MNC's operations. Consequently, the findings may be biased and not applicable for developing or transitioning economies.

   As Peng, et al. (2008) note, developing economies face a much more volatile, uncertain and dynamic institutional context than developing economies. Such economies therefore provide viable ground on which to research the subject further.

iv. A number of the studies are either conceptual such as Yildz and Fey (2012) and as noted by Schmidt and Sofka (2009) and Denk et al. (2012), qualitative studies may further illuminate the intricate effects of LOF on multinational firms.

Denk's et al. (2012) advice that resolving these gaps requires an understanding of three things:

- which hazard results in greater additional costs compared to another hazard;
- which action is most appropriate for addressing which hazard; and
- how MNCs can assess the mitigating and/or aggravating outcomes of pursuing a particular action.

Establishing the interdependencies of the LOF hazards and mitigation strategies will enable researchers identifying the optimal mix of strategies for managing the outcomes

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of LOF. Using the grounded theory of institutional theory, this research work is geared towards addressing the gaps identified above with a specific focus on emerging economies.

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3. Research Propositions

Denk et al. (2012) call for a more comprehensive understanding of the interrelatedness of the LOF hazards, addressing which hazards pose the greatest challenge(s), which actions are appropriate for which hazards and how MNCs can assess the mitigating and/or aggravating outcomes of pursuing a particular action.

Building on the conceptual framework adopted by Yildiz and Fey (2012) along the pillars of institutional theory and LOF, the following framework is envisaged as being useful in addressing these gaps:

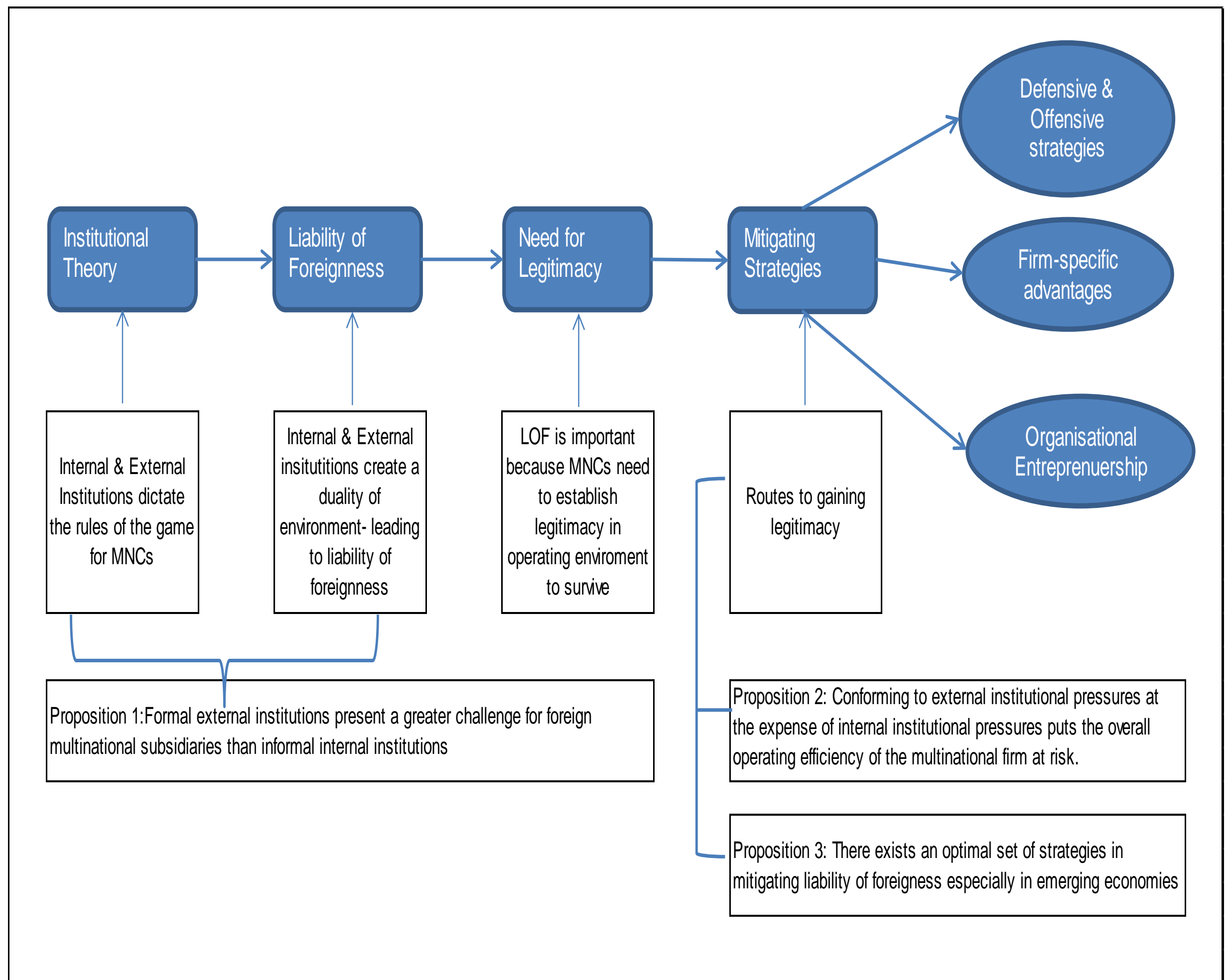

Figure 2: Conceptual framework for LOF; adopted from Yildz and Fey (2012)

The conceptual framework seeks to use institutional theory tenets to explain the gaps identified by Denk *et al.* ((2012). Hence the research study will seek to address the following propositions:

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3.1. Proposition 1:

Formal external institutions present a greater challenge for foreign multinational subsidiaries than informal internal institutions

Peng and Chen (2011) assert that institutions assert their influence informally (through norms and values) or formally (through regulations). They further point out that while informal means take their effect relatively slowly, formal pressures, often by the stroke of a pen, can materialize almost immediately.

It has been established that institutions are the source of LOF for MNCs, and as a means of survival, they need to establish legitimacy. By identifying which LOF hazards pose the greatest challenge for the MNC subsidiary and linking the same to its institutional source the research will establish the extent of the costs associated with the LOF hazards and whether interrelatedness exists amongst the LOFs.

3.2. Proposition 2:

Conforming to external institutional pressures at the expense of internal institutional pressures puts the overall operating efficiency of the multinational firm at risk.

Makino, Isobe and Chan (2004) posit that foreign subsidiaries face two sets of institutional pressures: external institutional pressures to conform to local demands in the home country, and internal pressures imposed by the parent firm to sustain consistency. The duo argues that conforming to external pressure by imitating local institutionalized practices may increase the legitimacy and the likelihood of survival of foreign affiliates. However, the duo cautions that such imitation does not necessarily make firms more efficient - it may actually limit the efficient transfer of the practices and routines on which the parent firms' strategic advantage is based from the parent firm to its foreign affiliates and hence affect the economic outcomes of their business activities.

Using institutional theory as grounded theory, this research proposition will serve a two-fold purpose:

i. Establish which actions are most appropriate for addressing which hazard; and
ii. Establish how MNCs can assess the mitigating and/or aggravating outcomes of pursuing a particular action

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4. Research Methodology

4.1. Research Design

The research propositions were addressed by adopting a qualitative exploratory multiple case study method (Eisenhardt, 1989). Yin (1994) outlines that case studies are rich empirical descriptions of particular instances of phenomenon that are typically based on a variety of data sources.

Saunders and Lewis (2012) state that case studies are useful in getting a detailed understanding of the context of the research and the underlying activities of the context. As noted in chapter 2 by Schmidt and Sofka (2009) and Denk et al. (2012), qualitative studies may further illuminate the intricate effects of LOF on multinational firms

4.2. Population

The population for the study was considered as executives of multinational subsidiaries in emerging markets.

4.3. Sampling

This research was intended to add to the body of literature by extending emergent theory on understanding LOF and developing effective strategies of dealing with the emergent effects.

As such, theoretical sampling, as opposed to random or stratified sampling was deemed as a more appropriate sampling technique as it allowed for cases to be selected on the premise they would be particularly suitable for illuminating and extending relationships and logic (Eisenhardt and Graebner, 2007).

Eisenhardt (1989) earlier stated that cases can be choses to replicate previous cases, extend emergent theory or fill theoretical categories and provide examples of polar types. In this instance, the cases were chosen to fill theoretical categories as outlined in the research questions.

Invitations were sent to 22 participants across 11 subsidiaries of the firm in Sub-Sahara Africa. Participants were drawn from the executive committee of the subsidiaries and represented Product Division Heads, Coverage Heads and Chief Executives of the subsidiaries. The choice of the cadre of executives was based on their understanding and entrenchment in the local subsidiary's strategy formulation and execution. 14 of the

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22 participants accepted the interviews; however one was unable to make the interviews and sent their response via email

The unit of analysis was the strategies undertaken by executives in dealing with LOF. The scope of the research was limited to executives in a large US bank operating in Sub-Saharan Africa. The underlying reason was premised on:

- Size and Scale of US banks in Emerging markets

According to The Banker's ranking of the top 1000 banks globally, US banks were ranked second in terms of Tier 1 capital behind those in the Euro zone (The Banker, 2012). As at the end of 2012, the US had 1,734 commercial banks of which 19 had foreign branches (US Treasury, 2012). Of the 19, the top three banks collectively had a total of 374 foreign branches.

Given the reach of American foreign branches especially in emerging markets, the research focused on executives of an American bank's subsidiaries in Sub-Sahara as the population. The choice of Sub-Sahara Africa as a region is premised on the basis that the continent comprises two emerging economies - South Africa and Nigeria and thus fits in well with the institution-based view of the firm which seeks to explain firm strategy in such economies (Wright, et al., 2005)

- Convenience and accessibility: The organization's executive team was easily accessible to the researcher.
- Consistency: There is a general alignment in the strategic focus amongst the subsidiaries as well as with the parent organization.

4.4. Data Collection

Eisenhardt and Graebner (2007) posit that case studies can accommodate a variety of data collection methods - including interviews, archival data, survey data and observations. The research method adopted entailed semi-structured interviews conducted with executives of the subsidiaries of the MNC in question. Interviews were done telephonically due to the geographic dispersion of the sample set - nine countries across sub-Saharan Africa and outside of South Africa - where the researcher is located.

Interviews were recorded using a digital device having sought acknowledgement from the respondents. Supporting notes were taken by the researcher during the interview

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as a back-up to the interviews and help in deducing the statements along the research objectives.

Data saturation was established at the 13th interview and data collection was stopped.

The total interview time amounted to 310 minutes and was done over a period of two months due to the interviewees' availability.

Table 1: Summary of Interview Statistics

Total interview time	310.34 minutes
Average interview time	23.87 minutes
Longest Interview	39.08 minutes
Shortest Interview	14.46 minutes

The recordings were uploaded onto an online file sharing system - Hightail and sent to an independent transcriber for transcribing purposes. Transcribed data was returned to the researcher within a day or two of the recording.

Challenges with data collection

- Due to extenuating circumstances some of the interviews were rescheduled which extended the data collection period
- Interviews were occasionally interrupted due to the busy nature of the respondent's schedules. However, this only delayed the interviews and not have any bearing on the content of the data
- Some respondents preferred to provide written responses rather than oral

4.5. Data Analysis

While the interviews were semi-structured and in-depth, there were a series of seven common questions that were asked across respondents:

- Briefly describe the strategic focus of the firm both globally and locally.
- What would you say informs this strategy?
- What would you describe as the key success factors in your local banking industry?
- Against these key success factors what would you say are the key competencies for your company?
- What are some of the key challenges you face in your strategy execution?

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- Of these challenges which would you say constitutes the greatest challenge?
- How do you go about addressing or mitigating these key challenges?
- Do you find that these actions have conflicting outcomes?

Using a deductive analytical method and based on the conceptual framework established in Chapter 3, codes were assigned to the common themes along these seven questions focusing on the strategic context of the firm, challenges faced in strategy execution, the strategic responses undertaken as well as any mitigating outcomes such responses bore to the firm. New codes were assigned as new themes emerged and these were classified into code families. A list of all the codes used and their categorized and family groupings is available in Appendix I.

To preserve the anonymity of the respondents, the transcripts were assigned pseudo names depending on the designation level of the respondent and their geographic location.

4.6. Research Limitations

As highlighted by Eisenhardt (1989), the combination of both qualitative and quantitative data is deemed ‘highly synergistic’. This is because, quantitative data indicates relationships that were not earlier evident and also keeps the researcher from getting carried away from what may be false impressions of the qualitative data. On the other hand, qualitative data is useful in explaining the theory underlying relationships.

Given the legal set up on the subsidiaries of the multinational firm, secondary quantitative data on each of the subsidiary performance was not available. This is because subsidiary financial information was reported along with the group information and no distinction or subsidiary-specific information was reported separately. Additionally attempts to obtain corroborating industry reports were not successful in all of the 11 markets in which the interviews were conducted. This stems from the fact that there are no common regulatory regimes, hence no standardized requirements of reporting financials. The lack of secondary, quantitative data may allow for some bias by the researcher in analysing the qualitative data from the interviews.

4.7. Data Validity and Reliability

Qualitative research is caveated as it is prone to vulnerability due to the researcher’s bias and potential proximity to the data (Saunders and Lewis, 2002). The geographic

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dispersion of the respondents and the different level of engagement with the company are deemed to be a mitigant to the risk of biasness.

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5. Results

5.1. Introduction

The preceding chapter discussed the methodology used to address the two research propositions outlined in chapter 2. This chapter presents the findings of the research questions used to address the propositions. The findings are structured around the conceptual framework outlined in Chapter 3 so as to establish a link between the propositions and findings from the research. The chapter begins with some information on the sample, the data analysis approach and then provides the findings presented using emergent themes from the data structured around each proposition. The findings of the propositions are them summarised at the end of the section.

5.2. Overall Description of the Company

As per the confidentially agreement entered into with the firm in this study, an overview of the individual subsidiaries of the company that were interviewed will not be provided. Such an overview will provided descriptive information that will enable the identity of the firm to be established and therefore contravene the agreement made. However, to provide some context that will prove useful in meeting the research objectives, the company can be said to be a global financial institution with substantive presence in Africa. The scope of the study focused on the firm's operations in Sub-Saharan Africa.

5.3. Sample Description

Invitations were sent to 22 participants across 11 subsidiaries of the firm in Sub-Sahara Africa. Participants were drawn from the executive committee of the subsidiaries and represented Product Division Heads, Coverage Heads and Chief Executives of the subsidiaries. The choice of the cadre of executives was based on their understanding and entrenchment in the local subsidiary's strategy formulation and execution. 14 of the 22 participants accepted the interviews; however one was unable to make the interview and asked for questions to be sent via email for their response. Whilst the response was received, due to the in-depth focus of the interview, it was excluded from the results to allow for consistency in the results presented. The written submission was however used to corroborate some of the responses provided during the interview. The results discussed in this chapter will focus on the 13 interviews conducted.

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Table 2: Level of Designation

Designation	Number
Chief Executives	4
Product Heads	6
Coverage Heads	3
Total	13

The executives interviewed collectively represented 155 years of experience with the company in Sub-Saharan Africa, with the average experience period spanning 12 years. The least number of years of experience was eight whereas the longest serving executive had 21 years to their name with the company.

In terms of demographics, 2 of the executives were female and the remaining 11 were male. The extent of the geographic dispersion of the 13 respondents is shown in the table below, most of the respondents being from Uganda, followed by Nigeria and Tanzania:

Table 3: Geographic Distribution of Respondents

Country	No. of Respondents
Uganda	3
Nigeria	2
Tanzania	2
Cameroon	1
Democratic Republic of Congo	1
Gabon	1
Ghana	1
Kenya	1
Zambia	1
Total	**13**

Due to the geographic dispersion of the respondents, interviews were conducted telephonically and recorded with acknowledgement from the respondents.

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5.4. Data Analysis Approach

Data from the interviews was analysed using content and frequency analyses to identify common and emergent themes as discussed in Chapter 4.

5.5. Responses to the Questions

In order to create structure and flow of the responses obtained in the interviews, questions were matched to the conceptual framework outlined in Chapter 3. This updated framework with the questions is provided in Appendix II. It is structured around three thematic areas aligned with the research propositions as shown below:

Table 4: Thematic Analysis of Data

Key Thematic Areas	Proposition Addressed
The institutional context in which the firm operates	Proposition 1
LOF: Drivers, impact and consequences	
Mitigating actions to LOF	Proposition 2

5.5.1. Proposition 1:

Formal external institutions present a greater challenge for foreign multinational subsidiaries than informal internal institutions

The following section addresses the institutional context in which the firm operates.

5.5.1.1. Briefly describe the strategic focus of the firm both globally and locally

This question was geared towards understanding the level of cohesion and alignment between the subsidiary and parent as regards their strategy. It also sought to establish the level of control the parent exercised on the subsidiary's strategic intent and to what extent the subsidiary had autonomy in formulating and directing its own strategy. This question laid the context within which to analyse subsidiaries' LOF.

The respondents defined the global strategic focus of the firm along three key themes:

i. Key competences the firm leveraged at the global level: technology and digitization were highlighted by most respondents.

The bank aims to be the World's digital bank…especially in the digitalized age in terms of transactions and you are seeing in the global changes…terms of payments, collection…the

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bank is plugging (in) to that stage…and that is what it is using to transform its operation globally (P 1: Chief Executive: Uganda – 4:4)

ii. Target market served: Three customer segments emerged from responses: global subsidiary companies, local corporates and public sector.

(We) seek to serve our individual communities and institutions and nations, with the significant experience of over 200 years… we try to create the best solutions for our customers and expand our coverage across as many global institutions as possible and also continue to serve our local corporate's and Government as they need (P 8: Coverage Head_Uganda- 8:8)

iii. Value proposition the firm displayed - this was described in terms of how the firm wanted to be viewed globally.

To be the most respected financial institution on the globe (P 8: Coverage Head_Uganda - 8:1)

In terms of the local strategic focus, responses were anchored around the client segments the firm served and the value proposition they wished to offer their clientele. Respondents spoke of leveraging their global presence to serve not only global subsidiary companies but also enabling local entities to expand globally.

> *Locally we want to be the bank that enables global companies to find a local footing. There are a lot of global companies as well looking to find occupation locally. Sometimes they don't have the expertise or local knowledge or understanding of the culture and we have focused on trying to bridge that gap for them. We also want to be the channel through which local companies have a global hold. (P 1: Chief Executive: Uganda- 6:6)*
>
> *The strategy locally is to focus on the corporate client which is our strength, at the global level that's our strength. We are a corporate and investment bank. From an international services perspective, we leverage the traditional products that the bank does - that are cash management and to all our corporate customers in order to ensure that we deliver shareholder value and make our customers and staff happy. (P10: Product HeadHead_Nigeria- 13:13)*

5.5.1.2. What would you say informs this strategy?

This question picks up from the strategic orientation established in question 1 and seeks to highlight the extent to which the subsidiary plays a role in the formulation of their strategy locally and how the global strategy plays into the local subsidiary's strategy.

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All respondents spoke of the local strategic orientation of the firm being derived using a 'top-down' approach where the subsidiary's strategy was determined at the group level and cascaded down to the local entities. Respondents also highlighted that there was a level of latitude executives were allowed to adopt the strategy to the local environment.

> *(Strategy) is taken from the top of the house and cascades to our subsidiaries but each subsidiary has the responsibility to adapt the strategies to its own local market. What will then happen is to get assistance if required from the head office to ensure we are all speaking the same language as a global institution (P 3: Product Head Nigeria- 13:13)*

> *The guidelines always first come from the top that is, we get the headlines from senior management as to what the direction of the company would be and once we get that direction` we at country level will sit back (and see) how we will plan and execute that strategy. (P 5: Product Head_Cameroon- 4:4)*

5.5.1.3. What would you describe as the key success factors in your local banking industry

This question was geared towards establishing the parameters for success within the banking industry from the perspective of the individual subsidiary. The question establishes the "rules of the games" – a concept that at the core of institutional theory and sets the stage for understanding the institutional factors that must be complied with by the MNC subsidiary in order to establish and maintain legitimacy locally.

Respondents identified four key success factors, around people, a good understanding of the local environment, strong value proposition and strong balance sheet coupled with proper allocation of resources.

i. People

This was the dominant key success factor identified by all respondents who noted the importance of having a skilled, talented, multi-faceted team.

> *The other thing is to have, in my view, a very motivated, talented team. This is probably in my view, in truth, the number one item… the process of identifying, motivating and retaining talent is essential to your success (P 1: Chief Executive: Uganda - 8:8)*

> *First one is people, it will, because in terms of skills, the skill set in the market is on a scale of low, medium, high is on the scale of medium. So it's extremely important to have the right people for a bank in Nigeria. (P10: Product Head_Nigeria – 37:37)*

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Its importance was premised on the need to safeguard the reputation of the firm, hence the need to have principled employees who would not compromise.

> *"If you have contracted employees who don't command presence in those markets, who are not regarded as principled, or who are even worse- compromised, then unfortunately you will end up with a compromised business (P 1: Chief Executive: Uganda- 8:8)*

Competition and rivalry in the banking sector was also noted to be high and therefore the need to distinguish oneself with a highly skilled team "who can develop the right product set for the firm's target market".

One respondent noted that the high cost of doing business in emerging markets required that the firm to have skilled people "who had a tight handle on strategic expense".

ii. A good understanding of the local market

This was found to construe a variety of concepts, the key ones being able to identify where the competition was, having a good grip on local culture and language and being close to the regulator so as to anticipate changes.

> *…so you need to look at each facet of what the local banks are doing, and you will see if you rely on your group strategy or policy it won't work because locally you need to do something different to be able to survive (P12: Chief Executive_Ghana- 14:14)*

> *Also language is very important… a key factor for the bank to operate in Gabon is the knowledge of French, you know, the local language is French. (P 2: Coverage Head_Gabon- 18:18)*

Being close to the regulator was found to comprise two aspects: Firstly - as a bank, the local regulatory requirements had bearing on the firm's operations hence, compliance was deemed key. Secondly- some respondents noted that regulations from a local perspective were being influenced by changes in the political landscape. An example was cited where a newly elected government's issued new regulations requiring reporting of all external flows of funds which has heavy bearing on how the bank and its customers operate.

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Another factor is a good handle on, but this is an emerging one, a very good handle on public sector policy….On economic policy, surrounding things like you know, fiscal management, okay, monetary policy… I might not necessarily have said this if you had asked me these questions four years ago but there's so much regulatory change in our industry alone. There've been huge regulatory changes in the space of three months. … Some you start off with a very broad overarching statement that we want to empower the locals so the locals can make money. But when you start to really unpack it, and you begin to see some of those sentiments you then start to see new policies coming in…So it becomes less and less about what is going to happen next month. What new regulation is going to bring out first? And it becomes more and more about what are you guys thinking. What is the general direction they are heading in? What is their overarching mandate? (P 4: Product Head Zambia: 31:31; 39:39)

iii. Strong value proposition to the client

This was identified as having a strong brand, differentiated product set, infrastructure and technology. The aspect of technology was particularly highlighted when serving multinational subsidiaries and also being useful in reducing the high costs of operating against an underdeveloped infrastructure.

The first one I would say that - is the branding...You are selling a trust-able organization... You need to be selling an organization that thinks ahead of time. (P11: Chief Executive_DRC – 25:25)

One is differentiation… differentiating yourself in terms of your platform. Identify who your key target market and then add value added products over and above what you are seeing in the market…We have a multibank center with 45 registered financial institutions ...where…7 banks controls about 60% of the assets and revenue… then it becomes a question of differentiating yourself against with the competitors.(P13: Coverage Head_Kenya – 12:12)

So a key success factor is being able to provide multi-nationals the same type of service and technology that they're used to, in terms of also gaining their efficiency. So technology is one aspect in that we are able to deliver the various solutions (P 2: Coverage Head_Gabon - 2:8)

Differentiation was deemed to be achieved by being 'innovative and continuously responsive' to the extent possible vis a vie the competition. This was especially so in banking where the products are homogenous and easily commoditized - where "everybody is able to replicate them which makes it difficult to command a price from the market" (P 7: Product Head_Tanzania – 13:13)

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The above key success factors were identified due to a variety of reasons; one being that a service oriented company "operated mainly via its brand". The need for infrastructure and technology was premised on the lack of infrastructure in the host countries which required banks to develop ways to reaching their clients; either through brick and mortar (physical branches) or virtual presence via technology. The lack of infrastructure was highlighted particularly respondents in the west and central region.

> *Generally francophone countries (in Africa) some are behind what we call Anglophone countries in terms of the financial intermediation or the financial sector. (P 2: Coverage Head_Gabon – 14:14)*

iv. Strong balance sheet and proper allocation of resources

Having the 'right amount of capital' was identified as a key component of a strong balance sheet. Additionally the right use of this capital was noted as a key component, wherein having the right risk architecture was deemed core to deploying the capital appropriately.

> *As a financial institutions you have to have the right amount of capital on your balance sheet, you need to have appropriate controls to run the financial institution and all the other tenets that form part of what you call CAMEL principles - capital, right management, and you know your assets have to be in right, in other words you shouldn't be able to the book assets that you will accrue loses from, everything has to tie up together. (P 8: Coverage Head_Uganda -17:17)*

> *…risk architecture, your risk organization, because this is also limited in the market. So you need to have very good quality of risk your organization. (P10: Product Head_Nigeria- 37:37)*

Firms that we deemed to possess these four key success factors were seen to be 'relevant to the local market' hence well poised to achieve "sustainable success", "through acquisition and retention of customers in spite of acute competition".

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5.5.1.4. Against these key success factors what would you say are the key competencies for your firm?

This question was asked on the back of the requirements for success within the local industry and sought to establish the advantages, where applicable that MNCs have over their local competitors.

The key areas of competence were established as having a strong value proposition as well as skilled people. The strong value proposition was embedded primarily in having a far reaching global presence which afforded the firm the "incomparable ability, to link customers from the local market into the global system". Having a global presence also allowed the local subsidiary to leverage off the global experience of the firm.

> *"We have the incomparable advantage, of experience, of markets of banking for example, where we have the genuine feel for the texture of the environment, the qualities and the position they call for." (P 1: Chief Executive: Uganda- 12:12)*

"The ability to leverage off global platforms" was also seen to contribute to a strong value proposition and allowed the firm to establish "natural partners" such as multinational companies who would be seeking the same experience across different countries. Additionally, respondents said that the global platform allowed customers "a sense of control and visibility of transactions and quick and easy reconciliation of the process". Customers derived a "sense of comfort" dealing with a global bank as they were seen to have "high standards" which meant their "operations will be above board".

One respondent succinctly captured the benefit the global platform provided:

> *The bank (operates) in multiple countries and we are providing a global platform to these clients in (locally) and at the moment for a long term we were the only bank providing such globality and locality at the same time to all of these corporates. (P13: Coverage Head_Kenya - 13:7)*

The global experience not only comes to bear when dealing with multinational companies but also with governments. Two respondents noted that in some instances, the firm is ahead of the regulator technologically and hence can be seen as a "trusted advisor" in assisting with market reforms.

This competence accorded the firm a form of first mover advantage in terms of offering new products and solutions as noted in one of the responses captured below:

> "…*we were the first bank to arrange a bond in the country; we were the first bank to*

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arrange commercial paper in the country. That has worked well for those clients who are looking for more sophisticated solutions in an emerging market like ours where solutions were not available locally. We are the first bank to offer fuel hedging for one of our clients; we were the first bank to offer coal hedging for mining clients, first bank to do a right issue under write again giving certainty to our clients in terms of funding to a large success. So all that factors basically drive the fact that you (are) looking for a sophisticated set of customers whose innovation requirements as well as transaction requirements are world class... requirements… so bringing the global platform helps support a lot of that development in the local market". (P13: Coverage Head_Kenya - 13:12)

In addition to enabling the local firm to establish a strong value proposition to its customers, it was also viewed as providing efficiency benefits in terms of research and development costs at a global level.

It is observed that the global platform and technological value propositions may be best aligned with other MNC subsidiaries operating in the country or local companies aspiring to go global. It might be inferred that such competencies may not be relevant to companies operating locally and seeking to establish themselves only locally - a point that was explored further in the following question.

Most respondents viewed people as the firm's key competence. One particular respondent noted:

"…We've got really good people. I see for a matter of fact a lot of people that work for the bank is key sources of talent in the market; we stand head and shoulder above our competitors in terms of talent". (P10: Product Head_Nigeria - 61:61)

5.5.1.5. What are some of the key challenges you face in your strategy execution?

Having ascertained that MNC subsidiaries have advantages that are not accessible to local firms, the next question focused on establishing whether there were gaps between the success factors earlier identified and the firm's capabilities. This would form the premise of Proposition 1, highlighting the firm's LOF, its sources and the drivers.

Three dominant themes emerged: external (home country regulations), bureaucracy and standardisation of processes and lack of infrastructure. Cultural differentiation emerged as a fourth theme but to a lesser extent.

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i. External (Home Country) Regulations

Respondents noted that local banks did not have to adhere to regulatory constraints such as sanctions issued by the Office of Foreign Assets Control (OFAC), as well as Basel III regulations. US regulations were noted as being core, given that the firm was a subsidiary of a US bank and hence the primary regulator would be the Federal Reserve and the Office of Comptroller of Currency (OCC).

> *A local bank may not have to adhere to OFAC regulations. They don't have to adhere to US sanctions. But as a global bank I have to adhere, so in the event that there's a new sanction, the local bank will not be an impacted by that.* **(***P 2: Coverage Head_Gabon – 34:34)*

The emergence of new Basel III requirements and the difference in their adoption across different geographies was particularly noted as being an uncompetitive factor for the firm, as local banks did not have to comply with the same rules.

> *"…The other challenge we have as a global institution is the differences in regulation, which creates some level of conflict. I will give you an example that illustrates a very interesting point where as a global institution the US market wants to move to Basel III by 2017/2018; Europe is also moving along the same lines in terms of capital adequacy and structuring by the same dates. However, the African market is beyond that and it is probably going to be later on in this decade or either somewhere in the early 2020's for the banks to comply with those rules. If you look at the Kenya situation, they are still regulated under Basel I rules...you've got the requirement to manage your capital under global requirements but then at the same time you've got the differentiation of the local requirement. This becomes a challenge or a drag for us because the new capital requirement under Basel III are the most stringent in terms of how you assess risk and how much capital you allocate to those risks as compared to Basel II which the local banks are competing on. And that differentiation is a problem"* (*P13: Coverage Head_Kenya – 24:24)*

> *For instance Basel II, Basel III, there are all these requirements…sometimes we are asked to reduce our liability growth because of the increase in assets that results in capital dropping in proportion to your balance sheet, so you are asked to scale down. Or compliance where you find that you aren't allowed to deal with certain markets like Iran or Iraq due to compliance issues (P 7: Product Head_Tanzania - 17:17)*

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Respondents cited that this has a drag on the performance of the firm as compared to local firms especially due to the high capital requirements since the firm had to incur a higher "cost of compliance" in meeting the additional regulatory requirements that the local firms did not face.

ii. Bureaucracy and standardization of processes

Respondents appreciated that with the size and reach of a global company, "the level of bureaucracy you get managing the company increases". Respondents noted that some of the global policies of their firm were seem to be restrictive in nature, especially around compliance to target market selection and customer due diligence; the genesis of which, were developments from the global financial crisis.

> *We have core policies that must be adhered to, regardless of the particular country you are in... I'll give you an example of what we call the customer due diligence process. Due to the recent events globally, the financial crisis and also the needs for more transparency within the US, this has placed a strain, or rather a lot of new requirements within the KYC aspect. (P 2: Coverage Head_Gabon - 2:18)*

> *So I'm looking at compliance-my compliance is expected to be top notch because I'm an American institution but the French who are the biggest in the market do not have that constraint. (P 5: Product Head_Cameroon – 12:12)*

> *Most of our problems are from the restrictive nature of our group strategy and trying to get approvals or exceptions that is where for me challenge arises. Because anything you want to do you need to find a way to fit it into to our internal policies or target market and make sure that there is no AML (Anti Money Laundering)/Compliance issue. (P12: Chief Executive_Ghana - 42:42)*

While the customer due diligence process was viewed as robust, respondents highlighted that this made customers to view the firm as being "documentation intensive". The need to comply with the standardized process makes the firm "inflexible" in its "approach to client engagement relative to market". The reason for this is highlighted in the below illustrative quote:

> *"The risk appetite remains low for emerging markets because subsidiaries are not assertive in the target market decisions. We need to educate risk personnel on the lay of the land and detract their ambition from having a low cost of credit to making calculated risk reward decisions." (P 4: Product Head Zambia – 92:93)*

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In addition to the conservative risk appetite of the group, respondents also noted that credit decisions are taken at the regional and head offices which disenfranchises the local staff and also results in "the level of risk skills in the subsidiaries being low because all decisions are taken at the regional and head offices.

> *"This means that relationship managers have a conservative understanding of risk and therefore a similar approach to client needs" (P 4: Product Head Zambia – 92:93)*

Restrictions were also cited on the credit policies which were deemed to be more stringent than local banks' requirements. The requirements included issues such as the target market selection and the minimum returns required from the loan if extended. Specifically, subsidiaries are required to operates with 'a risk averse" predisposition, without "any credit losses" while at the same time being required to "grow the asset (loan) book".

An extension of bureaucracy was cited in some aspects of decision making such as hiring decisions and investment research and development locally. One respondent cited the fact that the local strategy "gets superseded by events" from the global office as it's not prioritized especially when it comes to resource allocation. This leads to competition amongst subsidiaries and shifts management focus internally allowing for "competition to catch up".

The internal shift in focus was defined by one respondent as "the silo mentality" forms as individuals are unsure of their place in the "value chain" of the firm and try to safeguard their position by adhering to group policies as a way of legitimising their position within the firm.

> *I spend 60 per cent of my time internally and the other 40 per cent externally even though I would have liked it to be the other way round, but this is just that the structure that we are dealing with at the moment. We spend time on regulatory calls preparatory calls, to make sure you have the buy in. (P 7: Product Head_Tanzania - 7:28)*

The above restrictions or challenges make for a slow decision making process within the local subsidiaries as cited by all respondents. This is displayed in areas such as account opening where "documentation requirements are seen as onerous". Consequently, the requirements deter some local entities from dealing with the subsidiary as they take "the view that it will take too long because they need to get more documentation". Additionally, three respondents viewed the standardization of

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processes left them with little latitude to "transform (themselves) as quickly and as nimbly as (their) local counterparts do", which infers a loss of competitiveness resulting from loss of market relevance as illustrated below.

> *"Sometimes we are forced to structure our products based on global standards or standardizing them across different markets when each of the markets have their own nuances so it becomes difficult to incorporate those requirements in the product because they may not be applicable for your market. (P 7: Product Head_Tanzania - 17:17)*

One respondent confirmed this inference by citing that while the standardized process especially around risk and compliance made for a "fairly stable rate of return", the subsidiary was not "market leading in terms of return".

> *"While the market may be going up 30-40 percent or so since 2010/2011 amongst the local banks, the firm has constantly been just about 10-20 percent overall growth. So it (standardized processes) certainly limits the upside in terms of growth even though it does limit the downside in terms of losses and risks" (P13: Coverage Head_Kenya – 20:20)*

iii. Lack of infrastructure and branch network

Due to the global nature of the firm's operations and the focus on corporate and investment banking, the local firm's operations were limited in reach as they did not invest in 'brick and mortar' to reach the consumer or retail sector as local banks do. This was seen as an impediment to operations, especially in 'raising deposits'.

> *So they (local banks) usually have access to cheap funding which they can deploy into the market as various forms of investment. Now for us, most of the liabilities we have are quite expensive (P 9: Product Head_Uganda - 9:5)*

> *Well I think one of the added challenges that the business model has is for example, ability to attract local currency deposits which is not a problem for banks that have a wider footprint in the country, and banks that run consumer banking propositions. (P 6: Chief Executive_Tanzania – 20:20)*

The lack of infrastructure was deemed to impact on the firm's proximity to their clients and contributes to a loss of clientele especially among the local target market. However, one respondent observed that the need for infrastructure would become less

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relevant in the near future as the market embraced technology and digitisation of operations.

iv. Cultural Differentiation

One respondent noted that local customers "feel more comfortable" dealing with local banks due to language. This response was limited to one respondent and should be viewed cautiously as there could be other underlying reasons other than language or culture contributing to this observation.

5.5.1.6. Of these challenges which would you say constitutes the greatest challenge?

This question is the most pivotal in addressing Proposition 1; and seeks to affirm whether indeed external formal institutional factors present the greatest challenge for MNC subsidiaries.

The majority of respondents highlighted, bureaucracy followed by lack of infrastructure as the greatest challenges faced in executing strategy. One would infer this to mean that internal issues posed the greatest challenge for the firm. However, the factors driving the bureaucracy as discussed in the preceding questions speak to these challenges stemming from a mix of the home country's regulatory disposition (OFAC, OCC regulations) and the global organisations standards and policies being tailored around this.

Additionally, respondents highlighted that their frame of reference when executing strategy factors in the local regulatory aspect which they must adhere to as regulated financial institutions.

> *From the regulatory perspective (we don't see any) challenge as basically we reconcile the differences if any (between external) and local requirements; (the local) regulatory perspective always prevails (P 6: Chief Executive_Tanzania – 38:38)*
>
> *We need to know what the internal and external factors are, because at the end of the day, the entity that gave me a license to operate is the Bank of Uganda and, irrespective of whether I have my own internal requirements, I have to make sure that what my internal requirements are, they are in compliance with the local regulator (P 9: Product Head_Uganda – 27:27)*
>
> *In cases where are aligned in terms of internal policies but the external aspect does not*

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allow you to apply that policy…I go seek an exception to that particular policy and the bank does allow for that. (P 2: Coverage Head_Gabon – 50:50)

Summary of Proposition 1:

From this, the researcher infers that formal external (regulatory) institutional pressures pose greater challengers for foreign MNC subsidiaries. Additionally, it is inferred that these formal external institutional pressures cause the global company to align their operating policies along the regulations which are standardised across the group and possess a LOF to the MNC subsidiaries. Consequently, the firm is faced with LOF hazards of which the greatest is bureaucracy and standardisation which is referred to as a relational hazards.

5.5.2. Proposition 2:

Conforming to external institutional pressures at the expense of internal institutional pressures puts the overall operating efficiency of the multinational firm at risk.

The remaining sets of questions were focused on addressing Proposition 2.

5.5.2.1. How do you go about addressing or mitigating these key challenges

This question establishes how the executives address the key challenges outlined. Respondents identified innovation, internal lobbying and building external networks as the main ways in which they mitigated the key challenges of bureaucracy and lack of infrastructure respectively.

Innovation comprised aspects of:

i. Outsourcing to deal with the issues around limited resource allocation
ii. Developing "work arounds" to meet client needs. An example cited was developing local customised solutions to meet client specifications as they could not make changes to the firm's global platform.
iii. Leveraging the global platform to the extent possible:

"while other banks have taken the route of going through opening up branches and expanding their reach through brick and mortar outlets we have taken the technologic route and focus more in terms of providing online technology where you can do your banking wherever you are". (P13: Coverage Head_Kenya – 16:16)

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Internal lobbying was found to be directed to the issue of bureaucracy, where respondents highlighted that they first create ‘buy-in’ internally before proposing a solution. One respondent spoke of adopting a “venture capitalist” mentality and “take the business on a road show at all times”.

> *“You find that compared with my compatriots I have to spend more time socializing with players within the chain, before I can market a product to the external market (P 7: Product Head_Tanzania – 25:25)*

> *Well basically it means you need to do a lot of work to convince seniors, especially the risk people that this is worth doing. And prove to them the risk(s) are minimal, (and) the returns out way risk” (P12: Chief Executive_Ghana – 50:50)*

Establishing external networks and partnerships was highlighted as a means of dealing with the issue of infrastructure.

> *The issue of geographic footprint we mitigate and we fully resolve by getting ourselves into partnership with other partners local banks or you know partners in general.(P 6: Chief Executive_Tanzania – 26:26)*

> *So your strategy will be as you know to find a credible, a trust-able correspondent bank that has that presence from a landscape standpoint. (P11: Chief Executive_DRC – 17:17)*

5.5.2.2. Do you find that these actions have conflicting outcomes

This question addresses Proposition 2 and establishes whether the set of actions taken to mitigate the challenges are one - targeted at external or internal institutional pressures, and two - if indeed that is the case, such actions weigh down on the operational efficiency of the firm.

The firm’s activities around internal lobbying and establishment of networks are found to have conflicting outcomes. While internal lobbying was seen to be crucial in creating “buy-in” and “senior support” to fast track the decision making process, it was also seen as time consuming and led to the loss of first-mover advantage and a loss of credibility from the client’s perspective.

> *The time spent obtaining internal buy in leads to the loss of first-mover advantage. The*

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lack of results sends a message to clients that we are not responsive enough to their needs and therefore presents a risk to our revenues. You cannot just be client facing and not winning. (P 4: Product Head Zambia – 90:90)

One respondent described it as a “chicken and egg situation” where one needs to have the solution ready before bidding to a client, but needs to create the buy-in internally to build the solution which is a time consuming and expensive process.

Sometimes you can get people engaged before the customer has actually accepted the deal and you find that it happens in many transactions where before you bid you have to advertise the platform but building the platform is very expensive because you have to invest before the customer accepts otherwise you can’t bid. That’s just the big picture challenge where you need senior support even before you engage on a deal (P 7: Product Head_Tanzania – 25:25)

Networks and partnerships were used to respond to the lack of infrastructure, respondents found that this had conflicting outcomes. Whilst the partnership was seen as a “win-win” situation in that it allowed the MNC firm to bridge the infrastructure gap in meeting their client needs, it also allowed the local partner banks to leverage off the global firm’s experience and build their credibility. Notwithstanding this, the local partners were seen to evolve into competitors once they established their brand and systems and subsequently went for the global firm’s client base.

One respondent viewed the partner banks as “posing a risk” to the firm due to the dependency created on an independently managed firm that does not share the same code of conduct.

One respondent had a divergent view in terms of conflicting outcomes; highlighting that appropriate controls are put in place prior to engaging the partner bank - addressing the operational risk aspect. However, this does not address the partner bank becoming a competitive force.

(The Actions) don't have conflicting outcomes because in involving those actions we have to be cognizant of the fact that they must not conflict with the policies and institutional requirements that drive the soul of our business. That is why you go through complex deal reviews to ensure that whatever you are doing is consistent with the group policy. The process of evaluation ensures that lapses do not happen. (P 3: Product Head_Nigeria – 80:80)

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5.5.2.3. In your view is there an optimal mix of strategies you can employ

This was the concluding question to the interviews and sought to establish an optimal choice of strategies that the executives could be adopting to minimise the conflicting outcomes discussed above.

The question was not well understood by most respondents and had to be re-explained based on the input of the interviews. However a few themes did emerge as being the main strategies that the respondents explored, which might not mean they are optimal.

The responses were structured around developing a frame of reference and prioritising actions around that: "I think you have to focus on what is the priority and the priority is going to be meeting your global regulatory requirements as opposed to local regulatory".(P13: Coverage Head_Kenya – 29:29)

Right execution was deemed as key to being effective and therefore succeeding in the market. This was pegged on understanding the local environment and focusing on building relationships with the regulator.

No clear themes were established in this question due to the challenges outlined above and also because of a dynamic environment in which they operated.

> *The development of required causes of action to mitigate these challenges is a work in progress. The tactical approaches change as the market evolves and as such no determined optimal mix at any point in time. (P 3: Product Head_Nigeria – 86:86)*

Summary of Proposition 2:

The mitigating actions highlighted by respondents showed a greater focus on mitigating the external institutional pressures, which were already established in Proposition 1. Innovation, internal lobbying, networks and partnerships emerged as the key mitigants used. Conversely these were found to have conflicting outcomes on the performance of the firm.

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Table 5: Summary of Proposition

Challenge	Mitigants	Conflicting Outcomes
Bureaucracy	Internal Lobbying Innovation	Was seen as time consuming and led to the loss of first-mover advantage and a loss of credibility with the client;
Infrastructure	Networks and partnerships	Increased competition as local partners enhanced their credibility based on their experience working with the MNC subsidiary.

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6. Discussion of Results

6.1. Discussion of Results to Proposition 1:

Formal external institutions present a greater challenge for foreign multinational subsidiaries than formal internal institutions

6.1.1. The institutional context of the firm

6.1.1.1. Internal institutional context

The internal institutional context of the firm was established through the description of the strategic focus of the firm, globally and locally. Respondents described the firm's global strategy through three lenses- key competencies, target market served and value proposition.

Key competencies at the global level were defined as technology and digitisation strategies at the global level.

The local strategic context as defined by respondents was structured around serving specific client segments such as global subsidiary companies, public sector and local corporates using a strong value proposition. This was enabled through leveraging the global presence of the firm which allowed the local subsidiaries to not only serve global companies locally but also local companies looking to expand globally.

All respondents highlighted the fact that the local strategy was formulated using a "top-down approach". This is where strategy from the group level was cascaded down to the subsidiaries with some level of latitude afforded to the executives in adopting the strategy to the local environment.

The strategic context of the local subsidiary is closely linked to the parent company in terms of the market it serves as well as the competencies it is able to leverage to meet the needs of the target market. This introduces the internal institutional pressure that MNC subsidiaries face in strategy formulation- that of parental control. As posited by Mezias (2002), establishing parental control is important in understanding and mitigating LOF as it establishes the level of subsidiary autonomy which determines the extent to which the subsidiary can engage in local isomorphism to mitigate LOF.

Alignment to the group policy through the top-down approach of establishing strategy introduces the informal institutions (norms and values) that are internal to the organisation (Peng and Chen, 2011). These internal institutional pressures arise from rules imposed by the parent firm in order to sustain consistency (Makino et al., 2004)

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6.1.1.2. External Institutional Context

The external institutional context was first established through the key success factors within the local banking industry that respondents were asked to identify. This established the rules of the game (North 1990) that firms needed to comply with in order to gain legitimacy. Four key success factors were identified as below:

Table 6: Key Success Factors and External Institutional Context

Key Success Factor	Component	Purpose
People	Skilled, talented, multi-faceted team.	Safeguard reputation of the firm
		Mitigate competition
		Manage scarce resources
Good understanding of local market	Awareness of competition	Stay ahead of the curve
	Cultural integration	Acceptance by the customer
	Proximity to regulator	External legitimacy-comply with regulations
		Keep ahead of the time: Ems are dynamic
Strong value proposition	Brand	Mitigate competition
	Infrastructure	Ensure proximity to client
	Product suite	Meet client needs
	Differentiation/innovation	Mitigate competition
Strong balance sheet	Having the right amount of capital	Align with regulatory requirements; meet risk reward hurdles
	Right capital allocation	Risk averse

The key success factors lay the foundation for the external institutional pressures the firm faces (Peng and Chen, 2011). Respondents were asked to highlight the key competencies of the firm, against the key success factors identified. Two key competencies emerged: having multi-talented, skilled people and strong value proposition.

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Key competencies identified serves two purposes:

i. Established the extent to which the firm has legitimised locally- through means such as local isomorphism
ii. Affirmation that MNCs possess competitive advantages that local firms do not otherwise have access to. Therefore there is advantage to being foreign.

The identification of competencies such as technology and digitization capabilities speak to MNC subsidiaries having advantages that are not otherwise accessible to local firms (Sethi and Guisinger, 2002; Zaheer and Mosakowski, 1997).

The external and internal institutional context captures the duality of environments MNCs are exposed to and the resultant need to establish legitimacy- hence the occurrence of LOF. (Zaheer, 1995; Zaheer and Mosakowski, 1997 and Smidt, 2009). External regulatory pressures stemmed from the duality of the MNC- its globality and locality (Zaheer and Mosakowski (1997); and Kostova and Zaheer (1999) which forced the firm to establish legitimacy.

6.1.2. LOF Hazards or Sources

This was established through the challenges that respondents faced in their strategy execution, emergent gaps in the legitimisation process and therefore the source of LOF are established. Eden & Miller (2001, 2004) conceptual framework is used to analyse the challenges identified in the following page:

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Table 7: Challenges and establishment of LOF hazards

Challenge	Impact	LOF Hazard
External (home country) regulations	High cost of compliance hence drag on performance and lower competitiveness	Relational
*Bureaucracy and standardization of processes	Slow decision making process (extended value chain) therefore resulting in loss of competitiveness and market relevance displayed through lower returns compared to rivals	Relational
*Lack of infrastructure and branch network	Loss of market share due to lack of proximity to the client	Relational
Cultural Differentiation	Customer ethnocentricity led to local customers choosing to work with local banks	Discriminatory

**key challenges highlighted*

The application of Eden and Miller's (2001, 2004) framework establishes the presence of relational and discriminatory hazards.

Relational hazards stemmed from ownerships structures and the degree to which a foreign entity is integrated into the overall organisational structure of the home country headquarters (Nachum, 2003).

Discrimination hazards stem primarily from economic nationalism and a lack of legitimacy resulting in adverse treatment of the foreign firm by customers, as identified by Newburry, Gardberg and Belkin(2006)

Unfamiliarity hazards – which comprise of lack of embeddedness in local networks (Rangan and Drummond, 2004); and lack of specific institutional and host-market knowledge of the local business practices (Elango, 2009) were not identified. This can be explained by the fact that respondents identified that the need to understand the local market a key success. It is implied therefore that executives would seek to establish this success factor as part of their legitimisation process. Respondents also

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highlighted the need to be close to the regulator given the dynamic predisposition of the regulatory environment they operated in.

From the above summary, it is clear that relational hazards are at the fore front of issues facing the MNC subsidiary as they stem from the integration of the local entity subsidiary in the organisational structure of the home country (Nachum, 2003). The lack of infrastructure for instance, arose from the strategic disposition of the firm level to deal with a selected target market via a selected value proposition- technology digitalisation.

LOF were seen to impact the firm's operational efficiency through loss of competitiveness and relevance to the market. The impact of LOF had been discussed in the context of lower survival rates for MNCs than local firms as earlier identified by Zaheer and Mosakowski (1997). This was not displayed, implying that Mata and Portugal's (2002) assertion that MNCs and local firms do not display any variances in exit rate might be a plausible explanation. However respondents did not lower competitiveness and operational efficiency resulting from the challenges faced. These can be further explored to assert the extent to LOF impacts the firm.

Linking the above to institutional theory, both internal and external institutional pressures emerge. External - being from the dual regulatory environment the MNC subsidiary face and cultural differentiation.

With regards to internal institutional pressures, lack of infrastructure is a clear internal issue.

At face value bureaucracy and standardisation appear to be internally driven, further scrutiny on the issue of shows that some of the some of the processes emanated from the need to comply with home country regulatory requirements. These requirements included compliance to Anti Money Laundering and Sanction provisions which did not apply to local firms.

Bureaucracy is therefore deemed to be a double edged institutional pressure that emanates from the external environment and spirals into internal institutional pressures for the firm.

Impact of LOF

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The LOF hazards were seen by respondents as negatively impacting the firm's performance. This was on the back of lower operating efficiency and profitability as well as diminished competitiveness relative to the local banks. Zaheer 1995, Zaheer and Mosakowski (1997 Miller and Parkhe, 2002). Loss of competitiveness was attributed to the slower decision making process and the perception of the firm by customers as being rigid. The extended value chain and silo mentality factors also contribute to diminished competiveness. There were no examples of exists or few survival rates as asserted by Hennart, et al. (2002).

6.1.3. Conclusion of Research Proposition 1:

The preceding discussion established the existence of both internal and external institutional pressures facing the local subsidiary firms. The presence of institutional pressures create the need for establish legitimacy for the firm within the local operating environment- hence the occurrence of liability of foreignness. The research identifies key challenges faced by the firm, which are categorised as being either externally or internally generated. The research highlights bureaucracy as a key challenge with its roots in external regulatory issues. This emphasises the other challenge of external regulation as identified by the respondents.

Based on the above deduction, it is established that relational hazards pose the greatest challenge for MNC subsidiaries and more importantly seem to emanate from the external formal environment. Therefore the Proposition 1 is confirmed that formal external institutions present a greater challenge for foreign multinational subsidiaries than informal internal institutions.

6.2. Discussion of Results to Proposition 2:

Conforming to external institutional pressures at the expense of internal institutional pressures puts the overall efficiency of the multinational firm at risk.

6.2.1. Responses to institutional pressure

In response to the key challenges of bureaucracy and lack of network, respondents identified innovation, internal lobbying and establishment of networks and partnerships as key mitigating actions taken. This confirms the use of local isomorphism in

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establishing legitimacy (Luo, et al, 2002; Miller and Eden, 2006; Salomon and Wu, 2012)

The firm's mitigating actions are summarised according to the three strategies discussed in Chapter 2 used to establish local isomorphism.

Mitigating Action cited	Specific mitigating actions used	Grouping	Key Challenge
Innovation	Outsourcing	Organisational Entrepreneurship	Limited resource allocation (Relational)
	Developing work arounds	Organisational Entrepreneurship	Bureaucracy
	Leveraging global platform	Firm specific advantages	Lack of infrastructure
Internal lobbying	Standardisation and long decision making process	Organisational Entrepreneurship	Bureaucracy
External Networks	Lack of infrastructure	Local networking- Guanxi as well as Organisational Entrepreneurship	

Networking was established by Luo et.al (2002) in their study of Chinese firms – highlighting that *Guanxi* or local networks were important for establishing.

Use firm-specific advantages such as global technological platforms were established as a mitigating action especially in response to the lack of infrastructure – due to a limited branch network (Eden and Molot, 2002). This was found especially relevant when dealing with multinational companies who wanted to experience the same service globally and also for local firms looking to go global. This might denote that the firm-specific advantages may not be relevant at all times as alluded to by Miller et al. , who asserted that such advantages may be useful primarily in the developed markets. This assertion is supported by some of the respondents who noted that their operating environment faced operational challenges and high costs of doing business that may

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not always allow for use of the global platforms. An example cited was in Nigeria where access to electricity was deemed as a challenge.

Organisational eentrepreneurship emerged as the most commonly used mitigating action. Cantwell et al., (2010) found such actions to be particularly useful in situations of heightened uncertainties and complexities in the external environment. The research was conducted across several countries in Africa where institutional instability – politically and economic - characteristic of emerging economies- was present.

Internal lobbying, establishing innovative ways of meeting client needs and other factors earlier identified as proximity to regulator tie in well with Sethi and Guisinger (2002) who argued that it is not enough for MNCs to continuously monitoring their operating environment; they need to be swift in detecting changes in the environment and agile enough to adapt their internal procedures to be in sync with the environment.

From the above analysis organisational entrepreneurship or innovation and firm specific advantages are the two main mitigating actions taken by MNC firms, with the organisational entrepreneurship standing out as the key mitigating action.

This fulfils the second research objective of identifying which mitigating actions were best used under which prevailing LOF. However these actions should be taken cautiously as they have propensity to result in conflicting outcomes as described below.

Choice of strategy

Some of the firm-specific defensive strategies identified by Luo et al.,(2002), and confirmed by Mezias (2002) such as parental control and output standardisation. This can be explained by Luo's et al., assertion that defensive mechanisms were designed to reduce an MNC's dependence on the host country resources and its interactions with complex, uncertain, or hostile environments.

While output standardisation had been posited by Chirstmann and Taylor (2001) and Manrodt and Vitasek (2004) as being useful in reducing organisational complexity, the research establishes that these were in fact sources of LOF for the firm. As Mezias (2002) argued, LOF should be looked at in relation to the domestic firm performance, and by doing so the research establish that local firms did not have the extended value chain in decision making that arose from standardised processes.

The research findings point to banking sector being relational and service as established from some of the respondents' comments. Respondents highlighted issues

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such as proximity to the regulator and client as well as having access to highly skilled individuals as being key success factors for the banking industry. This denotes that banking and service oriented sectors need to be close to the environment- hence defensive strategies may not be applicable for firms in such sectors.

Conversely, the use of networking or (*Guanxi)* confirms to offensive mechanisms being more suitable enhancing an MNC's adaptability to environmental dynamics in a host country. Such activities are seen to elevate an MNC's organizational legitimacy as perceived by host country stakeholders.

6.2.1.1. Conflicting outcomes

Two of the mitigating actions identified - internal lobbying and networks and partnerships were found to have conflicting outcomes.

Mitigating Action	Focus	Intended Outcome	Conflicting Outcome
Internal lobbying	Bureaucracy	Create buy-in and senior support to fast track decisions	Extended the decision making process leading to loss of first mover advantage and credibility with the client.
Networks and partnerships	Lack of infrastructure	Win-win situation for MNC and local bank	Increased competition as local banks adopted the competencies of the global firm
			Heightens operational risk due to different cultural organisational mind-set

6.2.2. Conclusion of Research Proposition 2:

The above confirms that MNC subsidiaries took up actions to increase their legitimacy locally but with conflicting outcomes. This is in line with Makino et al (2004) firms undertook legitimatising actions though local isomorphism, they resulted in aggravating outcomes such as reduction of operational efficiency for the global firm. This was on the back of transfer of efficiencies to local firms that increased competition locally and therefore increased the risk of survival for the MNC.

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This is in line with Miller and Eden (2006) who argued that local isomorphism may be a self-defeating strategy in mitigating LOF. This is because as foreign firms adopt local strategies which are deemed legitimate, other industry players adopt similar strategies leading to increased competition which in turn increases the likelihood of failure.

The above leads to the confirmation of proposition 2 and also meet the research objective of which actions are appropriate in which state. For emerging markets, organisational entrepreneurship is deemed ideal and may have far less aggravating outcomes than other routes such as firm-specific advantages and networking

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7. Conclusion

7.1. Findings

The internal institutional context of the firm was established through the description of the strategic focus of the firm, globally and locally. The strategic context of the local subsidiary was found to be closely linked to the parent company with a high degree of parental control. This presented the internal institutional pressure that subsidiaries faced in their strategy formulation and execution.

The external institutional context was found to comprise of the key success factors that firms needed to display locally in order to succeed.

From this institutional context, liability of foreignness emerged from both relational and discriminatory hazards. More importantly, external regulatory factors and the global strategic focus to adhere to these regulations posed internal restrictions to the subsidiaries. The resultant effect was sub optimal performance of MNC subsidiaries compared to their local partners.

Bureaucracy and standardisation of processes along with lack of infrastructure were established to be the key challenges faced. Specifically, bbureaucracy was seen to stem from external regulatory issues, coupled with the regulator issues earlier identified by respondents, the research finds that external institutional pressures pose greater challengers than internal institutional pressures. Additionally, the key challenges were found to be rooted in relational hazards hence asserting that these pose the greatest cost to MNCs over and above discriminatory and unfamiliarity challenges.

Mitigating actions were seen to stem from organisational entrepreneurship and local networks were established to be most effective in enabling MNC subsidiaries deal with the challenges of bureaucracy and standardisation and lack of infrastructure respectively.

The use of mitigating actions is to be employed with caution due to the conflicting outcomes presented such as networks creating increased competition for firm when it is intended to bridge the infrastructure gap. Nonetheless, networks were found to have the least conflicting outcomes confirming that offensive mechanisms being more suited to enabling an MNC establish legitimacy especially in dynamic markets.

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Completing the conceptual framework that was introduced in Chapter 3 and which informed the structure of this research, the following framework is proposed in helping MNCs in emerging economies with their strategy formulation and execution:

7.2. Recommendations

A number of implications for management arise from the research, the key ones being:

- **To the global firm:**

  Increased engagement of the subsidiary at the point of strategy formulation and in strategy execution will better equip them to be more relevant and responsive to the market. This could be in the form more latitude in resource allocation decisions such as staffing or research and development and credit approval decisions.

- **To the subsidiary:**

  Objective and cautious adoption of the mitigating actions to address some of the challenges faced. While networks are seen to be the most optimal route, they may result in increased competition which may ultimately jeopardise the survival of the firm. Additionally, such partnerships may pose operational challenges in the shorter term due to lack of congruity in the organisations cultures.

Finally, and more generally, establishing an optimal mix of strategies may not be feasible especially in the context of emerging markets. This stems from the dynamic and unpredictable nature of some of the institutional factors such as regulation. However, having the right execution strategy will put the MNC in good form to be responsive to market changes and developments.

7.3. Limitations of the research

The findings of the research were based on a US bank operating in Africa. Data was collected from a sample of executives within the organisation and not all members of the executive committee. Therefore findings should not be generalised to all banks with foreign operations or other MNCs operating in Africa.

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7.4. Areas of future research

The following areas of future research are recommended:

- Use of empirical data and the comparison of the foreign firm to a domestic firm consider tenure of the MNC in the country in whether the LOF diminishes over time
- Establish a point of reference i.e. developed market firms vs emerging market firms- whether they face the same LOF
- Empirical evidence as to whether LOF reduces over time especially with use of firm specific advantages such as technology

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Appendix I: List of Codes and Families

Family	Code	Total
⊟ **Rules of the game loca**	KSF Outcome	1
	KSF Reason	1
	KSF_Local Market Understanding	1
	KSF_People/Skill	1
	KSF_Resources/Strong Balance Sheet	1
	KSF_Strong Value Prop	1
Rules of the game local Total		**6**
⊟ **Mitigating Actions**	Mitigating Actions_Innovation	1
	Mitigating Actions_Internal Lobbying	1
	Mitigating Actions_Network & Partnerships	1
	Mitigating Actions_other	1
	Mitigating Actions_Prioritisations	1
Mitigating Actions Total		**5**
⊟ **Competitive Advantag**	Competence_Other	1
	Competence_People	1
	Competence_Strong Value Prop	1
	Competence_Target Market	1
	competitive adv	1
Competitive Advantage Total		**5**
⊟ **Strategic Focus**	Strategic Focus_Global_Key Competence	1
	Strategic Focus_Global_Target Market	1
	Strategic Focus_Global_Value Proposition	1
	Strategic Focus_Local	1
Strategic Focus Total		**4**
⊟ **Institutional Weightin**	External>Internal	1
	Internal=External	1
	Internal>External	1
Institutional Weighting Total		**3**
⊟ **Source of LOF**	Hazard_Discrimination	1
	Hazard_Relational	1
	Hazard_Unfamiliarity	1
Source of LOF Total		**3**
⊟ **Institutional Envt**	Challenge_External Regulation	1
	Challenge_Infrastructure	1
	Challenges_Bureaucracy	1
Institutional Envt Total		**3**
⊟ **Optimal Mix**	Optimal Mix of Strategies_Organisational E/Ship	1
	Optimal Mix of Strategies_Prioritise frame of reference	1
	Optimal Mix of Strategies_Right Execution	1
Optimal Mix Total		**3**
⊟ **Key Hazard**	Key Challenge_Bureaucracy	1
	Key Challenge_Infrastructure	1
	Key Challenge_Other	1
Key Hazard Total		**3**
⊟ **Conflicting Outcomes**	Conflicting Outcomes	1
	Conflicting Outcomes_No	1
Conflicting Outcomes Total		**2**
⊟ **Impact of Hazards**	Impact of Hazards	1
Impact of Hazards Total		**1**
⊟ **Strategic Focus Driver**	Inform of Local Strategy	1
Strategic Focus Driver Total		**1**
⊟ **Consequence of Hazar**	Consequence of Hazard	1
Consequence of Hazard Total		**1**
Grand Total		**40**

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Appendix **II: Conceptual framework for responses**

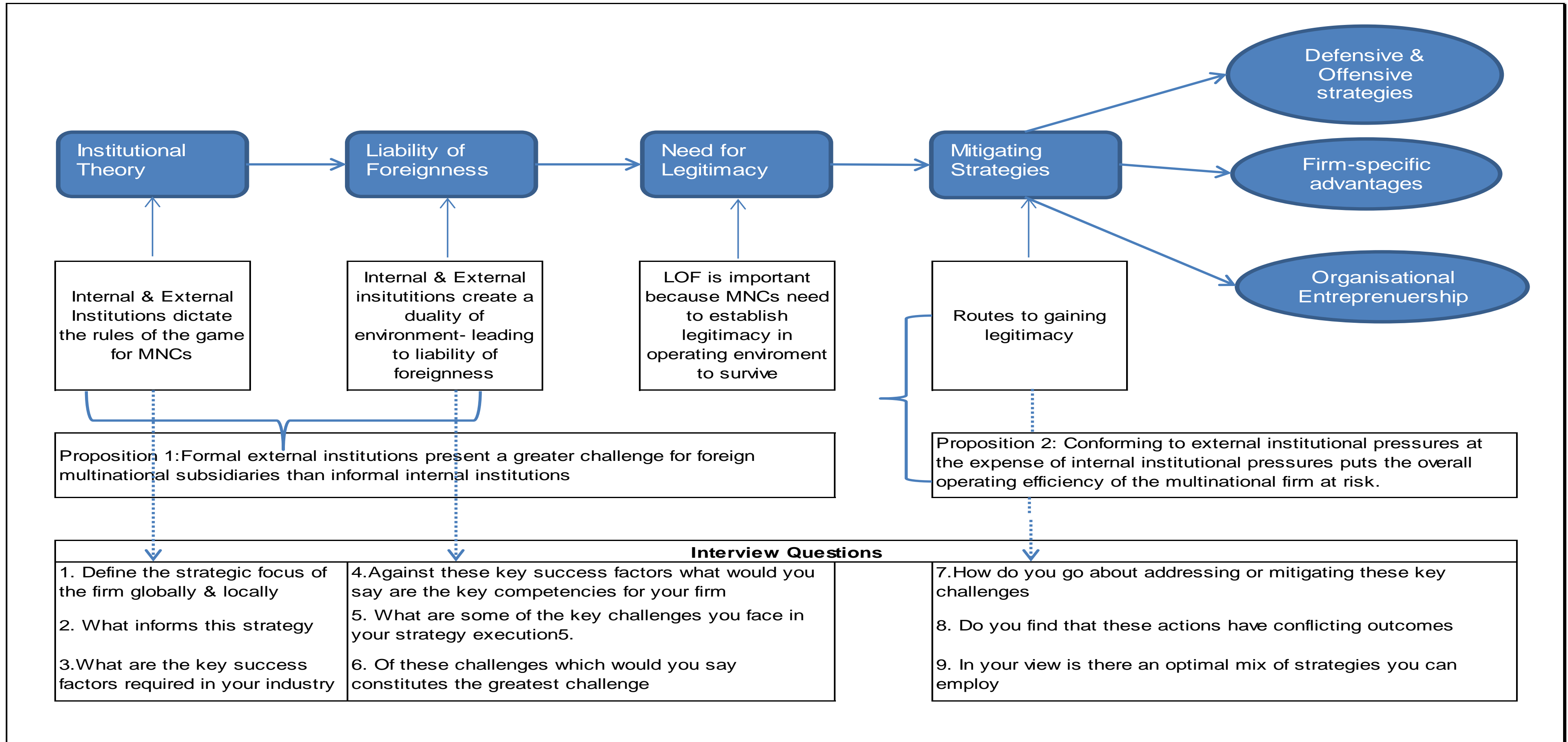

Figure 3: Conceptual Framework for LOF: with interview questions; adopted from Yildz and Fey (200=12)

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Consistency matrix

Research Proposition	Literature Review	Data Collection	Analysis
Proposition 1: Formal external institutions present a greater challenge for foreign multinational subsidiaries than informal internal institutions	Peng and Chen (2011)	Question 1 to 6	Content analysis on the key challenges and
Proposition 2: Conforming to external institutional pressures at the expense of internal institutional pressures puts the overall operating efficiency of the multinational firm at risk.	Makino, Isobe and Chan (2004)	Question 7 to 9	Content analysis on the mitigating actions respondents took, their efficacy and presence of conflicting outcomes

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