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CORPORATE GOVERNANCE AND INTERNATIONALIZATION STRATEGIES:  
THE LINK BETWEEN THE FAMILY AND ENTRY MODE CHOICES

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*To my Sun,  
whose light darkens the other stars.*



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## ABSTRACT

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The thesis examines family firms' internationalization strategies with a focus on the entry mode in foreign markets. Specifically, we investigate three dimensions of the entry mode choices, by employing corporate governance and family-specific theories. We provide an overview of three entry mode choices – location, establishment mode, and ownership mode – and some theories that have been adopted in the family firms literature – agency, stewardship, socio-emotional wealth, and institutional theories – that are also employed in the thesis. Building on these pillars, we argue that family involvement in ownership, governance, and management shapes firms' decisions when entering a foreign country. We follow recent advancements in the field that suggest how differences across family firms are relevant as much as the comparison between family and non-family firms. Accordingly, we both compare family and non-family firms' strategies and analyze differences within sole family firms, thus emphasizing their heterogeneity. In particular, we find that family firms pursue different entry mode strategies than their non-family counterparts because of diverse risk functions and family-specific assets. Further, disentangling the effects that family ownership, governance, and management have on the entry mode strategies help shed light on these firms' behavior in international markets and decision-making process. We test the hypotheses on a unique sample of Italian firms that undertake foreign investments between 2000 and 2013. The cover essay provides the conceptual framework of the thesis and summarizes the main findings, while the four appended papers more deeply analyze each of the research topics.



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## SUMMARY

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The purpose of the thesis is to aim to deepen current knowledge about the multinational enterprises' internationalization choices. In particular, we analyze the role of firms' heterogeneity in entry mode choices. The specific source of heterogeneity that we analyze is the involvement of the family in the ownership, governance, and management of the firm. The thesis relies on a broad stream of research in international business that concerns the entry mode choices, i.e., how firms decide to enter foreign countries through equity investments. Besides academic interest, understanding how firms expand across borders is of pivotal importance for both practitioners and regulators. Indeed, anecdotal and academic evidences show that internationalization is crucial to survive and grow in an increasing globalized context. Furthermore, as the last World Investment Report released by UNCTAD highlights, foreign direct investments suffered only in part the recent economic and financial crisis, while the aggregate investment in 2015 and 2016 grew at 11.4 and 8.4 percent, respectively. Therefore, we think that shedding more light on this issue may contribute to understand the dynamics of the foreign investments and some suggestions can be drawn for the private and public sectors.

Regarding the heterogeneity in corporate governance that we study, the thesis focuses on a peculiar form of business that is the family firm. Although it is the oldest business organization and one of the most frequent in many developed and developing countries, the analysis of their internationalization strategies is far from being satisfactory. Indeed, scholars often study only family small and medium enterprises – which are just a portion of the family firms' world – and/or they analyze only exports as internalization pathway. We expand these views, thus focusing on large family firms and investigating high committing – i.e., equity foreign investments.

Relying on these two pillars, the thesis investigates how family involvement in the firm influences three dimensions of entry mode choices. The three dimensions are the location choice (i.e., where to locate the subsidiary in foreign markets), the establishment mode choice (i.e., whether establishing a new venture or acquiring an existing local company), and the ownership mode choice (i.e., whether taking the full control of the subsidiary or sharing it with partners). Regarding the family involvement, the thesis adopts a multilevel framework that is not limited to the mere distinction between family and non-family firms. Rather, it tries to disentangle the effect of family involvement in ownership, governance, and management of the firm. The thesis tries to answer several research questions that relate to family firms' internationalization strategies. First, *do family firms differ from their non-family counterparts in selecting the host countries for their investments?* Second, *does heterogeneity in governance structures affect the establishment mode choice abroad?* Third, *considering the sole family firms, is heterogeneity within them a good predictor of their establishment mode choice? How the composition of the apical governance body (i.e., the board of directors) shape firms' entry mode choices?* Finally, *acknowledging that families are particularly interested in controlling their firms, does it hold true also in foreign countries? How firm-specific and contextual factors strengthen or weaken the families' need of control?*

The area of investigation is quite broad; therefore, the thesis is structured as a collection of articles in order to disentangle the several dimensions of analysis. However, the topics of the articles are connected and the cover essay provides a broader view of the whole configuration, the conceptual framework, the results obtained, and the key messages that the thesis aims to convey.

Paper A examines location choice decisions in family and non-family firms in terms of the influence of geographic and regulative distances on location choices. We posit that

family firms, compared to their non-family counterparts, prefer to locate their investments in countries that are more geographically proximate to their home country. Additionally, when considering regulative distance, we argue they are more likely to choose countries with lower levels of regulatory development than non-family firms. We also take into account the asymmetric effects in the analysis of regulative distance. Our results reveal that regulative distance affects family and non-family firms differently, whereas no difference is found regarding the impact of geographical distance.

Paper B and Paper C analyze the same entry mode dimension – i.e., the establishment mode choice – but the former compares family and non-family firms, while the latter focuses on the sole family firms. In particular, Paper B builds on the fact that extant literature on foreign entry increasingly recognizes firms' heterogeneity as a potential reason for inconsistency in results on the establishment mode choice. Our study contributes to this debate by identifying family ownership and family involvement in management as potential powerful sources of such heterogeneity. Integrating international business studies with both corporate finance literature on family firms and recent contributions from the socio-emotional wealth perspective on family ownership, we claim that, due to greater risk aversion and lower access to information, the family involvement both in the firm ownership and management leads to a higher propensity towards greenfield initiatives (vs. acquisitions). However, we also find that such a propensity decreases with international experience especially in family-owned firms given the greater ability of professionalized management to overcome family-related concerns on making acquisitions. Our analysis confirms our expectations, indicating family ownership as a significant driver of firms' international strategies.

Paper C examines how governance heterogeneity among family firms influences internationalization decisions, such as the establishment mode choice. Relying on agency

theory and stewardship theory, we argue that non-family board directors balance the families' preferences for greenfield investments, by enlarging the set of valuable strategic alternatives, and thus promoting more foreign acquisitions. However, if the family firm's founder has been appointed as the board president, her/him authority and charisma limit the influence of external directors, hence enforcing the family's dominant logic. After taking into account that the board composition may be endogenous to the establishment mode choice, we find empirical support for the hypotheses.

Paper D moves from evidence that recent applications of behavioral theories into the context of family-controlled firms assert a preference of family decision-makers for strategic actions that allow them socio-emotional wealth preservation, which ultimately means avoiding losing control of the firm. We identify the subsidiary ownership policy as being particularly affected by loss aversion tendencies of family leaders, and investigate trade-offs and interactions between performance and emotional hazards. We provide theoretical and empirical evidence that family leaders are either more or less willing to preserve family control – entering the foreign market by a wholly owned subsidiary – depending on whether the firm is exposed to low or high performance hazard. We show how this tendency is either weakened or amplified by the level of emotional hazard, pointing out that when low performance hazard matches with high emotional hazard the family leader's willingness to preserve family control through a WOS is stronger. Finally, we indicate that the influence of emotional hazard on family leader's decision about the subsidiary ownership policy weakens as the cultural distance between the domestic and the foreign country increases.

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## CHAPTER 1. INTRODUCTION

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The thesis has its roots in a lively debate in the international business and family firms literatures that has arisen recently. Scholars like Shaver (2013) wonder whether we really need more entry mode studies in international business research<sup>1</sup>. In particular, he worries that scholars are just playing the r-squared game, meaning that the trend is to maximize explanatory power without significantly advancing the knowledge of the field. From this point of view, it would seem that entry mode studies at hand depict how firms internationalize and we know much about it. However, other scholars such as Hennart & Slangen (2014) – commenting Shaver’s article – pave the way to more entry mode studies, because there are several dimensions of investigation that deserve attention and might help both academics and practitioners understand the real process behind entry mode decisions. Furthermore, Strange, Filatotchev, Buck & Wright (2009: 403) state “[...] both foreign and domestic investors may be heterogeneous. As such, firms with different ownership and governance structures may have different approaches to entry as they have different objectives from foreign entry”. These premises encouraged us to investigate the relations between corporate governance – as a source of heterogeneity – and internationalization, with a special focus on entry mode strategies. In particular, within several corporate governance structures, we investigate family firms for some reasons. On the one hand, family firms have been increasingly recognized as socially and economically dominant worldwide (La Porta, Lopez-de-Silanes & Shleifer, 2000;

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<sup>1</sup> By entry mode choices, we mean the set of decisions that a firm has to take when it decides to run an equity investment in a foreign country. See next sections for a more detailed identification of the phenomenon.

Gomez-Mejia, Makri, & Kintana, 2010)<sup>2</sup>. On the other hand, literature acknowledges important differences in family vs. non-family firms strategies (e.g., De Massis, Frattini, Pizzurno, & Cassia, 2015; Miller, Le Breton-Miller & Lester, 2010; Strike, Berrone, Sapp & Congiu, 2015), including internationalization (Arregle, Naldi, Nordqvist & Hitt, 2012; Fernández & Nieto, 2005, 2006; Majocchi & Strange, 2012). Indeed, recent advancements in family firms studies revolve around the idea that what makes family firms different from their non-family peers is the peculiar attitude of family owners to pursue economic as well as non-economic goals simultaneously, which constitutes one of the main drivers of the thesis.

The thesis aims to answer two sets of questions, which are driven by two different perspectives. The first one – which can be addressed as the international business perspective – would be: *how does heterogeneity in corporate governance affect the firms' entry mode strategies?* The second one – that we can label as the family firms perspective – would answer to the following question: *how do family firms internationalize with regard to the foreign equity investments?* However, we think that both perspectives are necessary to understand the phenomenon, while neither the former nor the latter are sufficient alone. Therefore, we do not adopt just one of the two. Rather, we try to combine them and take advantages of the synergies that they offer in order to analyze the relationships between international business and family firms. To do so, we investigate three dimensions of the entry mode – i.e., the location, establishment mode and ownership mode choices (see Chapter 2) – by employing theories used by family scholars in recent years – i.e., agency, stewardship and institutional theories, and the socio-emotional wealth approach (see Chapter 3).

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<sup>2</sup> FFs dominate not only in emerging economies, such as Asia (where they constitute approximately 95 percent of all firms), but also constitute 70 percent of all publicly traded firms in the US and almost half of the largest Fortune 1,000 firms.

The thesis is article-based and this cover essay introduces the main features that will be analyzed more deeply in the appended articles. The cover essay is organized as follows. Chapter 2 provides a review of the dimensions of the entry mode, an overview of applied theories and the main results on the topics. Chapter 3 describes the theories employed to the study of family firms, discussing their commonalities, their differences, and their relevance for the field. Chapter 4 provides the rationales underlying the papers, the main findings, and an introduction to the data used to test the hypotheses. Chapter 5 draws some conclusions of the thesis and paves the way for future research avenues.

The core of the thesis consists of four papers<sup>3</sup>. The objects of the studies are always the dimensions of the entry mode, while the factors explaining them are related to the family characteristics. The papers are quantitative and employ econometric analyses to test the hypotheses. I am either the main contributor or an equal contributing author of each paper. Specifically, paper A compares the location choices abroad of family and non-family firms. Paper B analyses the establishment mode choice of non-family, family-owned, and family-managed firms. Paper C, while still analyzing the establishment mode choice, focuses on the sole family firms and investigates how their heterogeneity in terms of family involvement affects this entry mode dimension. Finally, paper D studies the ownership mode choices of family firms, once again comparing different types of family firms under diverse internal and external conditions. Table 1.1 lists some details about the structure of the articles and their advancement.

As it emerges, the first two studies analyze the difference *between* family and non-family firms, while the third and the fourth papers investigate the heterogeneity *within* family firms. This choice reflects a raising trend in family business research that pushes towards

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<sup>3</sup> The papers have been submitted to international peer-reviewed journals; therefore, their outlets and reference styles are reported consistently with the journals' guidelines.

considering family firms heterogeneity in strategy studies (Chua et al., 2012). Specifically, several scholars argue that family involvement is not a dichotomous conditions; rather, families may act only as blockholders, they can be actively involved in management, they can appoint a closely-held board of directors, and they can be founder-managed. We posit that the above declinations of family firms will behave differently with regard to risk bearing and management when entering a foreign country. Therefore, we first show to what extent family firms differ from their non-family counterparts, and then we dig into the former to see how their heterogeneity influences entry mode choices.

**Table 1.1: Articles structure and advancement**

Paper	Entry mode dimension	Firm dimension	Co-authors	Journal	Status
A	Location choice	Family vs. non-family	Virginia Hernandez Paz <i>Universidad Carlos III Madrid</i> Maria Jesus Nieto <i>Universidad Carlos III Madrid</i>	Global Strategy Journal	1 <sup>st</sup> round R&R
B	Establishment mode choice	Family vs. non-family	Sergio Mariotti <i>Politecnico di Milano</i> Alessandro Minichilli <i>Bocconi University</i> Lucia Piscitello <i>Politecnico di Milano</i>	Journal of International Business Studies	Published
C	Establishment mode choice	Within family	Sergio Mariotti <i>Politecnico di Milano</i> Marco Mutinelli <i>University of Brescia</i> Lucia Piscitello <i>Politecnico di Milano</i>	Global Strategy Journal	1 <sup>st</sup> round R&R
D	Ownership mode choice	Within family	Claudia Pongelli <i>Luiss University</i> Alessandro Minichilli <i>Bocconi University</i> Guido Corbetta <i>Bocconi University</i>	Organization Science	Under review



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## CHAPTER 2. DIMENSIONS OF THE ENTRY MODE

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This chapter analyzes the set of decisions that a firm has to take when entering a foreign country through an equity investment. International business scholars have devoted substantial efforts to understand and explain which are the drivers associated with foreign investments. With reference to the scope of this thesis, we identify three dimensions that are worth investigating<sup>4</sup>. First, *where* to locate the firm's equity investment. Second, *how* the firm should enter the foreign country. Third, *how much* of the subsidiary's equity should be owned by the parent firm. The first dimension relates to the location choice, i.e., the spatial dispersion of the multinational enterprises' activities internationally. The second dimension pertains to the establishment mode choice, i.e., whether establishing a new venture from scratch in the foreign country (greenfield investment) or acquiring an existing and already active local firm (acquisition). Finally, the third dimension concerns the ownership mode choice – or subsidiary ownership policy –, i.e., the decision to hold the whole subsidiary's equity stake (wholly owned subsidiary) or have business partners (joint venture) who share benefits and risks of the foreign venture. There are some reasons why we select these three dimensions. In particular, we are interested in studying how family actors bear and manage risk directly linked to international activities. The three dimensions represent three different types of risks. Location choice directly refers to contextual aspects that might foster the family's ability to operate in certain locations and develop their institutional advantage. To be clear, we build on the notion that firms with different governance structure can adapt better to some contexts that are usually

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<sup>4</sup> We acknowledge that there are more decisions that a firm has to take with regard to internationalization – e.g., whether going abroad, whether pursuing an incremental internationalization process, the timing of the entry. However, since these dimensions are beyond the scope of this thesis, we do not report the studies that analyze other internationalization strategies in this section.

considered averse to develop business activities and more risky, i.e., where institutions are poorly developed. Establishment mode choice compares the different opportunities and risks of an internal (i.e., greenfield investment) and external (i.e., acquisition) growth strategy. We argue that the balance of these benefits and risks strictly depends on the characteristics of the investing firm. According to its characteristics, it may prefer to rely on more cautious and steady strategies or benefit of external skills brought by acquisitions. Finally, ownership choice takes into account the risk of sharing the subsidiary with a partner or establishing a wholly-owned one. We posit that risks preferences between the former and the latter vary according to the identity of the firm, besides to business considerations that are also taken into account.

When a firm decides to invest abroad, it has to make a decision on each of the dimensions outlined above. However, it is evident that these choices are not orthogonal, because some factors may influence each – or at least two – of the three dimensions. Let us consider the example of a country that raises barriers to economic freedom, which is a variable that has been shown to influence each of the three dimensions as also reported in the appended papers. It is likely that such a country will receive fewer foreign investments – in other words, it is not chosen as a destination country by the investor –, because usually firms are not willing to be influenced by governments in their business activities. Moreover, countries with low levels of economic freedom are likely to protect national firms by preventing acquisitions from foreign parties, and thus making greenfield investments relatively more probable than acquisitions. Finally, these countries' national legislations often require foreign firms to have a local partner in order to establish a company (e.g. Brazil and China), hence observing a large number of joint ventures that is not driven by business rationales.

The effects of family involvement in ownership, governance, and management on location choice (Section 2.1), establishment mode choice (Section 2.2), and ownership mode choice (Section 2.3) underpin this thesis and justify why we select these dimensions of analyses. Acknowledging that each choice is a fragment of the overarching concept of the entry mode in foreign markets, the rest of the chapter reviews how international business literature has investigated – both theoretically and empirically – each of the three dimensions<sup>5</sup>.

## **2.1. LOCATION**

Location choice is probably the milestone of international business research. Indeed, it is inextricably related to the spatial dispersion of business activities across borders. In the 1960s, scholars' interest was mainly devoted to the product cycle model and how it was disaggregated across countries (Vernon, 1966). However, in the following 20 years the attention of interest in location choice studies went into decline, while it rose again in the 1990s (Cantwell, 2009). The reason for such a decline is due to the shift of interest from macro and country level analysis to micro and firm level studies. In the early development of the international business field (see Kim & Aguilera, 2015 for a recent review on the issue), scholars analyzed location strategies through the lenses of international economics, thus viewing the foreign direct investments as capital flows influenced by exchange rates and other macroeconomic factors (Hymer, 1976).

However, some seminal works (Dunning, 1998; Krugman, 1991) paved the way for a reconsideration of the multinational enterprise as the central decision maker in the spatial aggregation of its activities, i.e., the location choice, since the firm is a node of intra- and

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<sup>5</sup> The following sections are not detailed and analytical literature reviews of the location, establishment mode and ownership mode choices. Rather, they provide the pillars on which the thesis builds on.

inter-organizational networks. Also because of a the rise of a globalized economy after some key political and economic changes in the last decades of the last century (e.g., new trade agreements, the rise of capitalism as the unique economic system worldwide), the interaction between firm- and country-specific advantages occurs most often in a more complex and interconnected economic system (Cantwell, 2009). Since the environment that firms face has dramatically changed, scholars cannot rely on theories that have been developed to model a different world (e.g. the product cycle model or the internationalization process), thus overturning the way scholars faced the issue both theoretically and empirically. Indeed, macroeconomic factors are seen as the context that multinational enterprises face, but they are not the main driver of the foreign investments. Instead, emphasis is given to the internal resources of the multinational enterprise, which have to be combined with the host country's characteristics in order to build and sustain a firm's competitive advantage. We try to clarify the issue with an example. Theories and general wisdom usually suggest that multinational enterprises avoid investing in countries with substantial level of corruption, because they would suffer of a restriction of their business freedom. However, Cuervo-Cazurra (2006) shows that multinational enterprise's prior experience in widely corrupted countries moderates such a general aversion to invest there, because they have learnt how to deal with less developed institutions. It is evident how this internal and firm-specific characteristic – i.e., a certain form of international experience – transforms a drawback into a source of competitive advantage. The development of the new institutional theory by North (1990) gave an additional boost to this stream of research. According to this theory, societies – and then countries – develop formal (e.g. laws) and informal (e.g. shared values) that define the criteria that guide the economic agents' decisions. As the example about the corruption clarifies, such institutions do not affect similarly every multinational enterprise; rather,

the combination of institutions and firm's characteristics is the crucial explanation of the location choice.

As a result, it is not possible to identify factors that attract or push away *every* firm; the effect that a location factor has on a firm's location choice depends on their interaction. We report here some findings that have been recognized as particularly relevant in the location choice strategy, although the list is far from being exhaustive. Extant research (for a detailed review, see Jain, Kothari & Kumar (2016)) has focused on firm's experiential learning (Dowell & Killaly, 2009), top management's background and network (Filatotchev, Strange, Piesse & Lien, 2007; Tihanyi, Ellstrand, Daily & Dalton, 2000) and industry characteristics (Pak & Park, 2005) as the internal/firm drivers of the multinational enterprise's location choice. With regard to the external/country drivers of location choice, they are the macroeconomic environment (Dixit, 1989) – such as the market growth, size, labor productivity –, the distances between the home and host country (e.g. psychic, cultural, geographic, and institutional distances), and the availability of natural resources (Asiedu, 2006).

## **2.2. ESTABLISHMENT MODE**

The establishment mode choice is one of the most investigated issue in international business since the first exploratory work of Wilson (1980) (Slangen & Hennart, 2007). The topic is particularly interesting because it compares two alternative modes of international firm's growth. The first is the internal and gradual growth associated with greenfield investments. When this mode is chosen, a parent firm opts for establishing a new venture from scratch, hence “exporting” to the subsidiary the organizational culture, the business procedures and routines, and the set of technologies that have been developed internally. The second growth mode is driven by acquisitions, which expose the parent firm to different organizational cultures, business practices and, most importantly,

technologies developed within the foreign subsidiary. Moreover, the debate has benefited from insight from other literatures that study the topic in both the domestic and foreign context (e.g. economics and finance), since acquisitions are a key topic in these fields.

Contrary to the location choice stream that has evolved significantly since its inception, research on the establishment modes are quite consistent over time, in terms of both theoretical frameworks and empirical structure (Slangen & Hennart (2007) provide a detailed review). However, this line of research shares with the location choice studies the need to combine internal aspects of the firm with the characteristics of the countries entered. The most used theory is with no doubt the transaction cost economics (Williamson, 1973), with a specific adaptation to the establishment mode (Hennart, 1982), which gives rise to the internalization theory. This theory describes the choice between greenfield and acquisition as a function of the costs associated with exploiting or obtaining intermediate inputs through these two establishment modes. When an input is deeply embedded within the parent firm, it may be too costly to separate it from the organization and combine it with an external entity as it happens in acquisitions. The risk of dissipating the competitive advantage associated to the input or being expropriated by third parties is too high, thus favoring the expansion through greenfield investments. This is the case of tacit knowledge – that is hard to codify and protect –, which characterizes primarily those firms investing massively in research and development. The same reasoning applies to product-specific technology, which is mainly experiential and tacit and, thus, hard to acquire in the market through acquisitions. When the firm's advantage is, instead, easy to separate from the parent, acquisitions should be preferred because the advantage can be combined with those of the subsidiary at a relatively low cost. Hennart & Park (1993) suggest that organizational ability and advanced management control

systems are the archetype of separable assets, because they may be easily transferred to the subsidiary.

The resource-based view of the firm reaches similar findings, starting from slightly different assumptions. It provides a tool to analyze how firms' resource endowments, in particular knowledge, generate competitive advantages for the firm (Barney, 1991). Firms can exploit their competitive advantage in international markets by transferring firm-specific advantages in foreign operations and applying existing knowledge. On the other hand, they can augment a firm's resource basis by the exploration of existing knowledge through organizational learning and access to complementary resources (Meyer, Estrin, Bhaumik & Peng, 2009). Within this framework, the establishment mode choice can be seen as the decision between exploiting firm-specific advantages through greenfield investments and the procurement of new technological resources through acquisitions (Barkema & Vermeulen, 1998).

Information economics (Stigler, 1961) expands the preceding predictions by focusing on the role of information processing in international contexts. Starting from the premise that each economic transaction is subject to information asymmetry and, therefore, to adverse selection and moral hazard (Akerlof, 1970), this theory prescribes that these features are exacerbated with foreign acquisitions, because there are additional barriers – e.g. language and culture differences, and lack of business networks – that increase the risks for the buyer. Since economic agents behave rationally, they should prefer greenfield investments in unexplored contexts, because acquisitions expose them to several transaction-related risks. However, this is not a static condition. Indeed, multinational enterprises may develop an antidote to these information asymmetries by obtaining more information about the host country through experience in that – or similar – context.

Scholars have identified some relations between country-specific dimensions and the establishment mode choice. We report here the main findings. Cultural differences hinder the information flows between the host country and the parent firm, as described by information economics. Namely, firms operating abroad suffer the so-called liability of foreignness (Zaheer, 1995). Scholars have conceptualized the liability of foreignness as the uncertainty associated with the distance between the home country and the host country (Zhou & Guillen, 2014). In the establishment mode dilemma, distance increases the information asymmetry between the bidder and the target company. Information asymmetry lowers the likelihood of acquiring a company because the bidder has fewer information about the target, hence exposing the parent to adverse selection and moral hazard (Ravenscraft & Scherer, 1987). Moreover, several host country factors push the investing firm opting for either greenfields or acquisitions. For instance, high-growing markets usually favor the installment of new production, because demand grows (Larimo, 2003); conversely, mature economies favor acquisitions, because they do not add new production – which could be hardly absorbed by the market – and these countries usually have more developed and transparent financial systems.

### **2.3. OWNERSHIP MODE**

Historically, ownership mode literature (see Brouthers & Hennart (2007) for an analytical review) has been developed together with the establishment mode one mainly by the same authors. As a result, these streams of literature rely on similar theories and sometimes the two dimensions have been jointly studied. Indeed, while some authors argue both theoretically and empirically that the two choices are independent (e.g. Hennart, 2000; Padmanabhan & Cho, 1996), others (e.g. Kogut & Singh, 1988) analyze the two aspects jointly, producing several possible combinations – i.e., partial acquisition, partial greenfield, full acquisition, and full greenfield.

Also in this stream of research, transaction cost economics is the most widely employed approach (Brouthers & Brouthers, 2003). In particular, this theory argues that full hierarchical coordination – i.e., wholly owned subsidiary – is preferred when asset specificity is high; on the other hand, partial ownership – i.e., joint venture – is more viable when asset specificity is low (Williamson, 1973). Therefore, as asset specificity increases, wholly owned subsidiaries are preferred to joint ventures, because the former leave less room for opportunistic behaviors (Delios & Beamish, 2001; Padmanabhan & Cho, 1999). In this framework, transaction cost economics shares with the resource-based view the focus on control over the subsidiary. Resource-based view theorizes that the nature of existing resources determines how a firm can grow by leveraging its own resources with external resources (Meyer et al., 2009). Putting together the transaction cost economics and the resource-based view arguments, the authors identify a set of choices that account for both the need of control and that of resource-augmentation. When a parent firm requires high levels of control and high level of resource-augmentation, it chooses a WOS. As these needs decrease, it will move towards a low-commitment entry mode, such as a JV.

Relying on information economics, one may argue that a multinational enterprise entering in a foreign country looks for a partner because it is not able to gather the relevant information to operate in that country. Indeed, doing business abroad exposes the firm to foreign countries and cultures (Zhao, Luo & Shu, 2004). Cultural distance increases the difficulty of dealing with a foreign market (Hofstede, 2001) and firms try to overcome this issue by having a partner, who can help reducing the risk associated with the foreign venture especially if they are already active in that country. Therefore, higher levels of cultural distance should lead to an increase in the likelihood of choosing a joint venture. Generalizing this point, when the liability of foreignness is a critical point for the

ownership mode choice, high-commitment entry modes lead to higher perceived risk, thus, in this cases, a low-commitment entry mode (i.e., JV) is preferred because having a partner helps reducing such liability (Hennart, 1991). Besides having a partner to share risks, MNEs can reduce the liability of foreignness through international experience in that foreign context (Contractor & Kundu, 1998; Delios & Beamish, 2001). Specifically, when a multinational enterprise acquires international experience, it is able to deal more effectively with foreign markets, different cultures, and legal systems. Therefore, the presence of a local partner that helps reducing the liability of foreignness is less valuable. Most empirical findings support this hypothesis and agree that experienced firms prefer wholly owned subsidiaries because they are able to reduce the liability of foreignness through experience (Gatignon & Anderson, 1988; Zhao et al., 2004).

As for the establishment mode choice, scholars have identified how local contexts in the host country influence the parent firms' actions. For instance, formal and informal institutions may push or prevent one of the two ownership modes. We already discussed the limitation of economic freedom as a cause of impediment, whereas other countries might draft legislations (e.g. pyramidal ownership, two-class shares) to facilitate control over the subsidiary, thus encouraging inward investments. Likewise, macroeconomic conditions play a role too. Investing in countries that are experiencing a financial and economic turmoil entails a large amount of risk, but sharing it with a partner is an effective way to be present in that market, without jeopardizing excessively the parent firm's risk.

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### **CHAPTER 3. THEORIES OF THE FAMILY FIRM**

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Although family firms are the oldest type of business organization, scholars' interest for the topic is relatively recent and this explains why the stream of research lacks of its own theories. Quite surprisingly, family scholars often borrow and adapt theories born to explain the structure of the managerial company, which is a far more recent organization than the family firm. This chapter provides a brief overview of the main theories that scholars most frequently use to describe and analyze these firms. The review is not exhaustive, but it is meant to lay the foundation for the studies that constitute the thesis. We start describing the agency theory (Section 3.1) in both its traditional and more advanced formulations. Then, we provide a brief illustration about the stewardship theory, with a special focus on the similarities and differences with the agency theory (Section 3.2). In Section 3.3, we report the basis of the socio-emotional wealth approach, which is not a proper theory, but it has the advantage of being the only conceptual framework that is family-specific. Finally, Section 4 outlines the institutional theory of the family firm, which was born to explain why family firms flourish in contexts characterized by poor formal institutions. Of course, the set of employed theories is broader than the four presented here (e.g., resource-based view, behavioral theory, stakeholder theory). However, the consideration of four mentioned theories is justified by the overarching idea of the thesis. Indeed, the four theories explicitly or implicitly state their assumption about risk bearing and management, and their effect on individuals' behaviors. We believe that these four theories better satisfy the need to model family's actions in foreign investments decisions.

### **3.1 AGENCY THEORY**

The inception of the managerial firm, which follows the second industrial revolution between the 19<sup>th</sup> and 20<sup>th</sup> century, provokes the formulation of a new theory that analyzes the relationships between shareholders and management (Berle & Means, 1932), i.e., the agency theory. However, the theory gains success from the 1970s, when it benefits from contributions from information economics and studies on risk sharing among individuals (e.g. Arrow, 1971). An agency relationship is characterized by the presence of one party – i.e., the principal – who delegates another – i.e., the agent – to perform a given task (Eisenhardt, 1989). The unit of analysis is, therefore, the contract between the principal and the agent. Concerning the assumptions, individuals are driven by self-interest, subject to bounded rationality, and risk averse. This is the model of man outlined by Simon (1957). Moreover, the organizations are characterized by partial goal conflicts and information asymmetries among agents, although information is a commodity that can be acquired at a given cost. Principal-agent problems give rise to two contracting problems: agency conflicts and risk sharing. The former derives mainly from the information asymmetries between the parties, therefore resulting in adverse selection and moral hazard (Akerlof, 1970). Adverse selection is an *ex-ante* agency cost because, given the high cost for principals to gather information, it is hard to distinguish good agents from bad ones. Consequently, principals offer a price (e.g. salary and benefits) that is between the price for good agents and the one for bad agents, therefore pushing the former to leave the labor market and keeping only the latter. Moral hazard, conversely, is an *ex-post* agency cost as it appears after the hiring of the agent. Since the latter possesses more information than the former – who has to bear a cost if wants to gather it –, agents have the incentive to deviate from the contract (e.g. lack of effort and extracting private benefit). The risk-sharing problem is somehow related to moral hazard. Indeed, principal

and agents usually have different risk functions, which push them to bear a dissimilar portion of risk. For instance, diversified shareholders are not affected by the idiosyncratic risk of a single firm, because they diversify their portfolios. On the contrary, managers are dependent of a single firm (i.e., the one they manage) as human capital is less diversifiable than financial capital; therefore, they are unwilling to bear excessive idiosyncratic risk. Taking advantage of information asymmetries, agents take actions in accordance with their risk functions, at the expense of their principals. Research in the field have analyzed how principals may align their interests with those of the agents, e.g. through efficient capital and labor markets (Fama, 1980), the board of directors as a monitor system (Fama & Jensen, 1983), and managerial ownership and equity incentives (Jensen & Meckling, 1976).

Agency theory argues that information is too expensive for principals, starting from the premise that there are several and fractioned shareholders. However, when a blockholder is present, it has the critical mass to monitor effectively the managers. Unsurprisingly, agency scholars have detected blockholdings as one of the efficient mechanisms that moderate principal-agent conflicts (Anderson & Reeb, 2003). This circumstance raises another issue at the shareholders level, which is particularly fruitful when analyzing family firms. Indeed, majority shareholders have the incentive to influence the management in order to pursue their own interests, even at the expense of minority shareholders (Morck, Shleifer & Vishny, 1988). Such costs borne by minority investors are usually labelled as principal-principal agency costs. Adverse selection, moral hazard and risk sharing are still on stage, even though actors and outcomes are different. Let us consider the case of a firm owned by an undiversified blockholder and several diversified minority shareholders, which is far to be an exception in many developed and developing markets (La Porta et al., 1999). The blockholder is not able to diversify idiosyncratic risk

– thus being subject to a risk function that is similar to that of the managers – and then it backs up the management in taking low risk strategies, contrary to the minorities' preferences. It is suddenly evident why agency theory has been widely employed in the family firm context, because family firms are by definition characterized by the presence of large – and often undiversified – blockholders, and they shape firms' strategies and performance (Anderson & Reeb, 2003; 2004; Anderson, Duru & Reeb, 2009).

The case of family firms in agency theory is not only a special application of a more general theory. Indeed, while the assumptions and features described so far hold true, the peculiarities of family firms expand the agency arguments. To start with, families have a long-term horizon as they wish to transfer their firm to the heirs. In particular, they are characterized by altruistic behaviors among family members, which often give rise to nepotism (Schulze, Lubatkin & Dino, 2003). Indeed, competition for holding managerial positions is frequently confined within family boundaries, regardless of the real ability of the heirs to manage the firm (Villalonga & Amit, 2006). As a corollary, talented non-family individuals are not willing to hold non-managerial positions, because they recognize the impossibility to reach higher roles. The result is an adverse selection of the non-family employees. Furthermore, several control mechanisms that moderate agency costs are softened in family firms. The market for corporate control is hardly effective as family firms are often unlisted and, even if listed, families are not disposed to sell their stake. Additionally, the role of the board of directors as a conflict moderator strictly depends on whether the family decides to appoint external directors, since it has the majority to control the board.

To sum up, it is hard to assess theoretically whether family firms are more or less exposed to agency costs than their non-family counterparts are. It depends on the relationship between founders and heirs, the separation between owners and managers, and the

misalignment between majority and minority shareholders. However, empirical research has shown that agency costs in family firms are lower than in other firms (Chrisman, Chua & Litz, 2004) and that founder-governed family firms are less affected than heir-governed ones (Villalonga & Amit, 2006) in line with agency arguments.

### **3.2 STEWARDSHIP THEORY**

Stewardship theory is another widely accepted theory in the family firms context and its predictions are often at odds with agency theory ones. The main difference between the two theories regards one of the assumptions about the model of man underlying the two theories. Indeed, the steward shares with the agent the risk aversion and bounded rationality; however, individuals in stewardship theory are modelled as self-actualizing rather than self-interested. This is the model of man outlined by Argyris (1973). In stewardship theory, “managers are not motivated by individual goals, but rather are stewards whose motives are aligned with the objectives of their principals” (Davis, Schoorman & Donaldson, 1997: 21). It is important to stress that stewards are still rational; however, contrary to the agency assumptions, they receive a higher utility from pro-organizational and collectivist behavior than from self-serving and individualistic one. Therefore, assuming that the stewards and principals’ interests are not aligned, cooperation acquires more value than defection for the stewards<sup>6</sup>.

What are the premises that underlie the different assumption between agency and stewardship theories? The seminal work of Davis et al. (1997) identifies psychological and situational factors. Briefly, the former category includes motivation, identification, and the use of power. Motivation regards the kind of rewards that the individual is looking

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<sup>6</sup> A clarification is required here. In fact, each economic relationship requires (at least) two parties. It means that behaviors could diverge with one party that adopts an agency behavior, while the other follows a stewardship one. The result is that the former will take advantage of the latter, whereas the latter feels frustrated and betrayed. We do not analyze this aspect here – that would be modelled as a repeated simultaneous game – since it is beyond the scope of the thesis.

for. Agents would prefer extrinsic rewards with a monetary market value, which also constitute control systems that protect the principal from opportunistic behavior. Although stewards need monetary goods in exchange of their work, they do not aim at maximizing it, because they look for higher order goods, such as opportunities for growth, achievement, affiliation, and self-actualizing. With regard to identification, it occurs when individuals feel belonging to a greater community (e.g. the family, the firm). While this aspect has no impact on the agent, it is of primary importance for the steward, because it constitutes the basis to reach higher order goods. Finally, individuals benefit from the use of power. However, power may be institutional – i.e., it derives from the different roles in the society, such as the shareholder and the manager – or personal – i.e., it comes from individual characteristics and regardless of the position held. While the former shapes the behavior of agents, the latter drives the behavior of stewards.

Situational factors refer to aspects that are not individual-specific, but rather depend on the context in which people operate. They can be categorized in risk orientation, time frame, and cultural aspects. Risk orientation pertains to the actions that individuals take to manage risky situations. Let us consider the case of an incomplete contract, as is the relationship between shareholders and managers. Society characterized by skepticism and prudence would solve the issue by creating control systems that minimize risks. Conversely, risk-taker and confidence-based societies would create a system of trust, where both contractors take some risks, but minimize the costs of control. The former would opt for agency relationships, while the latter for stewardship ones. Since trust may require high front-end investments in terms of risk-taking – that will be rewarded in the long run – and needs more time to consolidate, stewardship relationships usually require individuals to be longer term oriented than those operating under agency conditions. Finally, cultural aspects play a prominent role. Hofstede (1980) distinguishes countries

according to their propensity to individualism or collectivism. It is self-explanatory that individualistic societies promote the adoption of agency behavior, whereas collectivistic ones favor the inception of stewardship relationships.

As for agency theory, many of the prescriptions that stewardship theory, which refer to the shareholder-manager relationship, apply to the interactions between majority and minority shareholders. Indeed, relying on the previous discussion, if we assume that blockholders behave like stewards, they are not interested in expropriating minorities, but rather in pursuing the organization well-being, thus benefitting all the stakeholders interacting with it. Saying it in stewardship words, blockholders receive higher rewards by cooperating with minorities than pursuing private benefits at their expense. For instance, blockholders may decide to open the board of directors to minorities' representatives (in excess to those already appointed by minorities), and external and independent directors with peculiar skills needed to foster the firm's growth, rather than exercising a mere control over the board according to the portion of equity held.

The model of man underlying stewardship theory and the general description of family individuals in family firms seems to be alike. Family members are motivated by higher order needs that go beyond the mere monetary reward, such as the will to increase the family well-being through the firm's growth (Anderson & Reeb, 2003). Moreover, identification with the organization is a key factor for family members, because there is a close overlap between the family and the firm (Habbershon, Williams & MacMillan, 2003). Likewise, the power relationships in the family firm are based on personal ties, rather than institutional ones. For instance, the power that the founder may exert on family members and other stakeholders derives from her/his history and charisma, rather than from the fact that s/he is the firm's owner. Indeed, s/he is able to exert such a power even when s/he is not the main shareholders anymore (Kelly, Athanassiou & Crittenden, 2000).

Further, relationships among family members are more likely to be based on mutual trust – because of altruism – rather than control. Finally, family members wish to transfer their firm to their heirs, therefore they naturally have a long-term horizon, which is conform to the premises of stewardship theory.

### **3.3 SOCIO-EMOTIONAL WEALTH APPROACH**

Although some authors refer to the socio-emotional wealth model, even its proponents prefer to consider it as an approach (Berrone, Cruz & Gomez-Mejia, 2012). Indeed, socio-emotional wealth should be more precisely labelled as an approach, perspective or model, rather than a theory. However, we prefer to describe this approach here, because it has encountered vast and growing favor in family firm studies. Therefore, at its inception, socio-emotional approach does not spring from an analytical theoretical formulation, but rather it tries to reconcile some inconsistent findings in the family firm literature, even though more accurate conceptualization are emerging recently (Chrisman & Patel, 2012). However, this is a quite an interesting peculiarity, because the socio-emotional wealth approach does not originate in other business or economics fields and then it is adapted to study family firms, as it happens for agency and stewardship theories; rather, it is typical of this type of firms as it is meant to encompass their peculiarities in a general model. Furthermore, it shares some characteristics of both the agency and stewardship framework that will be described below.

The socio-emotional wealth approach relies on the behavioral agency model (Wiseman & Gomez-Mejia, 1998), which builds on agency theory (Jensen & Meckling, 1976) and prospect theory (Kahneman & Tversky, 1979). The behavioral agency model challenges the agency assumption that individuals are *always* risk averse (see Section 3.1). Instead, according to prospect theory, the risk-taking behavior changes with the framing of the

problems. This theory argues that individuals frame problems by comparing anticipated outcomes from available options against a reference point. The reference point is mainly subjective and depends on individual preferences and contextual factors (e.g. for an enterprise, it may be the last year's growth rate or the industry's average profitability). Individuals become risk takers when they face options that are below the reference point; conversely, they are risk averse when available options are above the reference point. The shift of risk taking from negative to positive situations underlies the notion of loss aversion, which contrasts agency's risk aversion. Loss aversion regards the individual's propensity to take actions that avoid losses, even if entailing a higher risk. As a corollary, loss averse individuals are more sensitive to report losses than attracted by potential gains. This loss-aversion behavior explains why individuals are risk taker when they face negative situations – i.e., they are willing to take risky actions in order to avoid losses –, while they become risk averse when facing positive contexts – i.e., they avoid taking risky actions that may erode the existing profit. In other words, when individuals have much to gain and relatively few to lose (i.e., they are in the loss mode), they opt for risky actions because the potential upside overwhelm the potential downside. Conversely, when individuals have much to lose and relatively few to gain (i.e., they are in gain mode), they opt for less conservative options to safeguard the expected profit.

If socio-emotional wealth takes from behavioral agency theory the tools to model individuals' behaviors, it uses stewardship theory to define the object of analyses. Indeed, families' utility function assign more weight to non-economic factors than financial wealth. This is in line with Argyris's model of man underlying the stewardship theory, i.e., individuals feel more rewarded by higher order and intrinsic goods than monetary and extrinsic wealth (see Section 3.2). Specifically, families are loss averse with regard to the stock of affect-related value that they derive from its controlling position in their

firm. However, what constitutes the affect-related value? Berrone et al. (2012) describe the dimensions of socio-emotional wealth that are related explicitly or implicitly to stewardship's features. These dimensions are family control and influence, identification of family members with the firm, binding social ties, emotional attachment of family members, and renewal of family bond to the firm through dynastic succession. They are also known with their acronym, i.e., FIBER. Let us consider them singularly. Family control and influence is probably the most important dimension and it is the premise for the others. Indeed, the primary goal of families is to hold the stake in their firms and to exert control over their strategies. It is tautological that, without control and influence, it does not exist the family firm. Identification with the organization – i.e., the firm – is one of the premises of the stewardship theory (see Section 3.2). This provokes that internal and external stakeholders view the firm as an extension of the family with several consequences on their strategies. Indeed, family firms avoid taking actions that will undermine the family's reputation, hence exhibiting higher levels of corporate social responsibility (Berrone, Cruz, Gomez-Mejia & Larraza-Kintana, 2010). The identification is even strengthened when the family name is part of the firm name, thus suggesting a direct and close association. Binding social ties refer to the set of relationships that family members establish with external stakeholders that go beyond the mere business relations. The literature provides several examples of such ties, e.g. with time-honored vendors and suppliers (Uhlener, 2006), customers (Miller & Le Breton-Miller, 2005), and stakeholders in general (Cennamo, Berrone, Cruz, & Gomez-Mejia, 2012). In stewardship terms, this is a reinforcement of the collectivistic view of the organization, rather than the individualistic and opportunistic one. Furthermore, socio-emotional wealth is constituted by emotional attachments. This is probably the most characterizing feature of family firms and refers to the role of emotions in the business

context. Emotions are the basis of families' interactions and, because the boundaries between families and firms are often blurred, firms are permeated and shaped by emotions. The relation is even more complicated because the family firm constitutes a source of emotions for the family (Sharma & Manikuti, 2005), thus leading to a self-reinforcing tie. Once more, we can reconcile this dimension of the socio-emotional wealth with the look for higher order goods in stewardship theory. Finally, we have the dynastic succession. This element is crucial to understand the time horizons that characterize family firms in contrast with managerial companies. Since families are longstanding entities, the wish to maximize the likelihood of survivorship of their firms in order to pass the control to the heirs and sustain their well-being. Consequently, strategies vary accordingly leading to the outcome that long termism – rather short termism – marks out family firms. However, this feature is consistent with the premises of stewardship theory, because stewards need long periods of interactions to develop trustful relations (see Section 3.2).

To sum up, socio-emotional wealth approach starts from the behavioral agency model that defines individuals as loss averse rather than risk averse, as in traditional agency theory. Moreover, it builds on stewardship prescriptions to identify a broader construct of wealth, which goes beyond the mere financial wealth, i.e., the socio-emotional wealth. Putting the two aspects together, controlling families in family firms are averse to loss in socio-emotional wealth, which is the sum of the FIBER dimensions. Empirical results provide substantial support for the socio-emotional wealth approach (e.g. Gomez-Mejia, Cruz, Berrone & De Castro, 2011; Gomez-Mejia, Haynes, Núñez-Nickel, Jacobson & Moyano-Fuentes, 2007), especially when firm leadership is in the hands of the family (e.g. Miller, Minichilli and Corbetta, 2013; Minichilli, Nordqvist, Corbetta and Amore, 2014).

### **3.4 INSTITUTIONAL THEORY**

The review of the theories used to study family firms has so far focused on how the family control influences the firm strategies and performances. In other words, these theories assume an organizational view of the family firm, while taking for granted their existence. This section aims to take into consideration the circumstances that favor the inception of family firms.

The presence of family firms in modern economies is quite a puzzle for neo-classical economists. Indeed, family firms raise barriers to the efficient use of resources through markets. For instance, they do not select their managers from an efficient labor market; rather, apical positions are often devoted to family members, which leads to severe adverse selection of employees at any level of the firm (see Section 3.1). Furthermore, families do not benefit from diversification benefits from owning several stakes in low-related industries and are often limited in the selection of their financing, because they avoid diluting the control over the firm. In other words, they do not operate in efficient labor and capital markets. According to neo-classical theory, these inefficient firms should exit the market, as they cannot sustain competition with more efficient ones (Casson, 1999). However, reality contradicts this prediction with centenary family firms still active. Moreover, the share of family firms is not uniform internationally, but rather it varies evenly across regions that share similar institutional development (La Porta et al., 1999). Therefore, a stream of research has focused on the institutional factors that favor or hamper the inception and flourishing of family firms. In particular, family firms are vastly present in developing countries (e.g. India and South-Eastern Asia) and those with relatively poor institutions (e.g. Southern Europe and Latin America), while they are rarer – although present – in countries with stronger institutions (e.g. the United Kingdom). As Bertrand & Schoar (2006: 76) argue, “family ties serve as a second-best

solution in countries with weak legal structures, since trust between family members can be a substitute for missing governance and contractual enforcement.” In a broader sense, family firms internalize some economic transactions within their boundaries, because of market inefficiency. This is true for informal institutions too. Indeed, in less developed countries, entrepreneurs often rely on their and relatives’ personal capital to start a business (Colombo & Grilli, 2007), since the banking system does not finance them because of the low protection of their loans. However, family firms is a governance choice that allows individuals to take advantage of weak institutions too. Burkart, Panunzi & Shleifer (2003) develop a formal model that shows how families may tunnel private benefits from their company at the expense of minority shareholders, when institutions are poorly developed. Furthermore, Faccio (2006) argues that family firms are more able to deal with corrupted environments. Indeed, families are particularly effective in accumulating social capital, such as building informal networks and giving them long-term orientation to such relationships (De Massis, Kotlar & Frattini, 2013). When these relationships are developed with politicians – especially in corrupted environments –, they allow family firms to benefit of public resources, e.g. subsidized credit, government contracts and favorable legislation (Betrand & Schoar, 2006). Furthermore, politicians prefer to deal with family firms because of their long-term orientation that assure long-lasting relationships and their network of social capital, which can serve as an electoral constituency (Morck & Yeung, 2004).



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## **CHAPTER 4. THESIS DESIGN**

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The three dimensions considered of the entry mode and the theory used in family firms' studies are of paramount importance to develop the thesis. Indeed, building on these pillars, we analyze how the two literatures cross-fertilize themselves and how they contribute to advance each other. More specifically, four papers constitute the thesis and each of them relies on some aspects of the theories examined in Section 3.

### **4.1 PAPERS STRUCTURE**

Paper A builds on institutional and agency theories. It examines location choice decisions in family and non-family firms in terms of the potential effects of geographic and regulative distances. We first posit that family firms prefer to locate their investments in countries that are more geographically proximate. However, it emerges that geographic distance does not affect differently the two categories of firms. We discuss this result highlighting that we consider large family firms that are likely to possess the tools to manage the costs deriving from physical distance (e.g. differences in time zone and transportation costs). Additionally, when considering regulative distance, we argue they are more likely to choose countries with lower levels of regulatory development. This second hypothesis directly derives from the prescription of institutional theory (Section 3.4). In fact, building on the fact that family firms may have a competitive advantage in poorly developed institutional context, they feel more comfortable to operate in worse context than the home country. Contrarily, non-family firms possess skills – e.g. more international experience and professionalized managers – that favor them in more developed countries. We also challenge the typical view that family firms just prefer to

stay “close to home”. Indeed, if research considers that foreign countries are just *distant* from the domestic market, rather than *better* or *worse*, it may drive to wrong results and provide mistaken implications to academics and managers.

Paper B studies the differences in the establishment mode choice in family and non-family firms. Here we suggest that firms’ heterogeneity helps explain inconsistencies in results on the establishment mode choice. As a source of heterogeneity, we study the role of family involvement in firm ownership and management. Integrating the international business framework with contributions from the Socio Emotional Wealth approach and agency theory, we assert that families lead firms to prefer greenfield initiatives (vs. acquisitions) due to their risk aversion and lack of information. We expect that this preference should increase as the involvement of the family rises. However, no significant difference emerge between family-owned and family-managed firms and we discuss this finding highlighting how commonalities between family-owned and family-managed firms are larger than differences. The propensity towards greenfield investments decreases when the firm possesses more experience in the host country, especially in family-owned firms because their professionalized management is more able to absorb and leverage it. Besides examining how family firms differ from their non-family counterparts in the establishment mode, we try to emphasize the need to include more governance aspects as differentiating and explanatory factors of internationalization strategies.

Paper C follows the route started in Paper B. We study the establishment mode choice but from the perspective of the sole family firms. Indeed, we posit that the board composition in family firms is a driver of the establishment mode choice in foreign markets. We start from the premise that families feel more comfortable with greenfield investments as it emerges from Paper B. Then, relying on agency theory and stewardship

theory, we argue that non-family board directors balance the families' preferences for greenfield investments, by enlarging the set of valuable strategic alternatives, and thus promoting more foreign acquisitions. However, according to the stewardship theory, we find that personal rather than institutional power (see Section 3.2) drives relationships in family firms. Indeed, if the family firm's founder has been appointed as the board president, her/his authority and charisma limit the influence of external directors, hence enforcing the family's dominant logic and pushing the firms to make greenfield investments. Furthermore, we propose empirical progress in the analyses of the relations between family involvement and firm strategies, by showing how the board composition is endogenous to the establishment mode and alerting scholars to take consideration of these aspects in future research.

Paper D analyzes the ownership mode choice made by family firms abroad, distinguishing firms according to their leader's membership – i.e., family vs. non-family leader. The main goal is to investigate loss aversion tendencies of family leaders, and investigate trade-offs and interactions between performance and emotional hazards. Moving from the evidence that research on strategic management and international business has rarely investigated the impact of corporate ownership structures on leaders' behaviors in front of important strategic choices, we challenge the prevalent notion that major managerial decision in family firms are driven by socio-emotional wealth preservation, even if doing so might entail higher financial risks or lower performance.

Disentangling performance and emotional hazards, we contribute to the growing debate on the contextual nature of socio-emotional wealth preservation logic, by showing how family leaders' strategic decision-making depends on the actual emphasis that those two hazards have within the family firm. We provide theoretical and empirical evidence that family leaders are more or less willing to preserve their socio-emotional wealth – entering

the foreign market by a wholly owned subsidiary – in relation to the level of performance and emotional hazards fit between the family and the business. We conclude that family identity is the most relevant driver that characterizes SEW-oriented decisions in family-controlled firms, as shown in the context of culturally distant foreign investments.

#### **4.2 METHODS AND DATA**

The four papers are quantitative and employ several econometric techniques in order to take account of the nature of the dimensions studied varies; hence, empirical models adapt to fit the data and the relationships that we test.

Empirical findings rely on a unique database, which derives from the merge of two proprietary datasets and several public sources. The first proprietary database is Reprint (Mariotti, Mutinelli & Sansoucy, 2015), developed at Politecnico di Milano, which lists information on foreign entries undertaken by Italian firms worldwide. Such data are obtained from the companies' annual reports and crosschecked with press releases, newspapers and company websites. This database provides information on the country entered, the establishment and the ownership modes chosen. The second proprietary database is the AUB observatory on Italian family business (Miller et al., 2013), which is developed at Bocconi university. It lists information about the governance dimension, e.g. family' equity stake in the firm, board of directors and apical management composition. It derives from the match of accounting and financial data retrieved from AIDA (the Italian branch of the Bureau van Dijk data provider) and governance information obtained from official public filings stored at the Italian Chamber of Commerce (Amore, Garofalo & Minichilli, 2014). All the firms in the sample are large companies, meaning that they report more than 50 million of euros of revenues. This threshold is of paramount relevance for the scope of the thesis. Indeed, previous research has often studied small and medium

family firms, which leads to the result of mixing the effect of being small with that of being family-controlled. We rule out this effect by considering only large firms. The dimensions of analysis also support this choice. Specifically, we consider only equity investments abroad that requires significant financial and managerial resources. Small and medium enterprises are likely to face the shortage of these resources, thus being *a priori* constrained to the internationalization strategies.

The number of observations used in each paper varies according to the research design. For instance, some articles (papers A and B) compare the strategies of family and non-family firms, while others (papers C and D) are limited to only family firms. Therefore, the exact description of the sample is postponed in the methodological section of each paper, where it is described with detail the perimeter and the rationale of the sample.

#### **4.2 MAIN FINDINGS**

This section tries to provide a general overview of the results of the thesis with the aim of identifying a *fil rouge* across the papers. First, we note that family ownership is relevant only when distinguishing between family and non-family firms, while its effects is negligible when comparing different types of family firms. In other words, a great impact on internationalization strategies is due to the presence of the family blockholder; the level of blockholding is much less relevant. This general finding is compliant with the predictions of agency theory.

Additionally, we show how family firms are not a unique block that behaves uniformly, even when operating abroad. Whether the family firm is managed by a family manager, how managers are subjected to performance and emotional hazards, the presence of external stakeholders – e.g., in the board of directors – or the founder dramatically change the family firm strategies. In general terms, we can observe a range of family involvement

that encompasses several dimensions: ownership, governance, management, personal involvement, emotional ties, and such. Then, claiming that family firms are more risk-averse, less innovative, or less internationally experienced does not capture the real nature of these firms. Rather, we find that only a small proportion of family firms operates in reliance on the traditional view of entrenched and risk-averse firms, which are those family firms where the presence of external stakeholders is minimized, are slightly affected by business risks, while the emotional tie between the family and the firm is maximum.

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## **CHAPTER 5. CONCLUSIONS**

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The thesis combines two perspectives on the relationships between entry mode choices and family firms that complete each other. Namely, heterogeneity in corporate governance – and specifically that deriving from the family involvement in ownership, governance, and management of the firm – contributes to explain the entry mode strategies that firms pursue in foreign markets. Likewise, the internationalization strategies – with particular reference to high-committing equity investments – deserve more attention from scholars. Accordingly, we adopt a double point of view of the issue, thus merging theoretical predictions and empirical evidences from the two fields in order to fulfil the purpose of advancing existing knowledge on the topic. As a result, contributions range across both fields.

The first contribution of the thesis is to the international business literature. It tries to provide a thorough analysis of heterogeneity in corporate governance on the entry mode choices, without limiting to just one dimension. Therefore, we aim to show how families react to and face different decisions, which bring diverse benefits and risks to their firms. Furthermore, we adopt a multilevel approach and show how decisions are intertwined. For instance, we do so by considering country factors – that are mainly related to the location choice – in the establishment and ownership mode decisions or by creating a matrix of decisions, as the four outcomes deriving from the combination of establishment and ownership mode choices.

The second contribution is more related to the family firms literature. Indeed, we try to open the black box of family control investigating several dimensions of it. We claim that family control is not a unique construct that has the same effects on the firms' strategies.

Rather, we decompose it and analyze the relations between different mechanism of governance – e.g. family ownership, family management, the role of external board members and the founder – on relevant internationalization choices.

The third contribution regards the selection of the sample but has an impact on the conceptualization of the phenomenon too. Indeed, previous studies often considered the internationalization pathways of small and medium family firms, which could raise the doubt that findings are more related to size, rather than being a family firm. Selecting large family firms has the advantage of netting the effect of being small, thus confirming that family firms adopt different strategies in the international markets compared to their non-family counterparts. In particular, those characteristics – e.g., risk aversion, emotional behaviors, altruism, and protection of family-specific assets – that have been identified as drivers of small family firms' strategies influence also large ones.

The thesis is not exempt from limitations; rather, such limitations raise the opportunity to investigate other aspects related to those already discussed in the thesis. To start with, it would be interesting to study whether the way in which family firms shape entry mode decisions has an impact on performances. This is mainly an empirical issue. Indeed, foreign choices regard a single entry mode, which is a foreign subsidiary. Accounting and financial data on foreign subsidiaries are often difficult to gather because the parent firm presents a consolidated annual report from which it is hard to comprehend the data of the subsidiary. One possible alternative is to consider the parent firm performance rather than the subsidiary one. The problem here is that causality would not be assured. Indeed, parent firms are large companies and it is hard to claim that their performance are significantly influenced by the right entry mode strategy in a foreign market. Conversely, it is likely that their performance depends on a myriad of factors and the entry mode decision is just one among others. Furthermore, consistent with previous research, we think that

analyzing the mechanisms that lead to a given business action adds value for both academics and managers. Future research could overcome this problem by collecting subsidiary level information on performance (e.g., survivorship, financial performance, growth) and, thus, analyze which is the relationship between the involvement of families in firms' strategies and the outcomes. Furthermore, the thesis rely on firms that are located in Italy. Although it is an ideal test bed because of the large presence of family firms, it would be interesting to see whether these findings hold in countries with different market structures and institutions. Finally, there are other decisions related to the entry mode that are beyond the scope of this thesis that could be investigated – e.g. whether going abroad, whether pursuing an incremental internationalization process, the timing of the entry. Future research should analyze whether firms' heterogeneity affects these choices as it happens with the three dimensions analyzed in the thesis.



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**PAPER A. INTERNATIONAL LOCATION CHOICE IN FAMILY FIRMS: THE  
ROLES OF GEOGRAPHIC AND REGULATIVE DISTANCES**

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**ABSTRACT**

This study examines location choice decisions in family and non-family firms in terms of the potential effects of geographic and regulative distances. We posit that family firms prefer to locate their investments in countries that are more geographically proximate. Additionally, when considering regulative distance, we argue they are more likely to choose countries with lower levels of regulatory development. We also take into account the asymmetric effects in the analysis of regulative distance. Drawing from a sample of Italian firms operating internationally between 2000 and 2013, results reveal that regulative distance affects family and non-family firms differently, whereas no difference is found regarding the impact of geographical distance. We discuss these results through the lenses of the resource-based view, agency and institutional theories.



## **Introduction**

International location decision has been broadly explained by the literature. International Business (IB) research has studied how host country factors and the differences between home and host countries affect this decision (Flores and Aguilera, 2007; Ma, Delios and Lau, 2013; Majocchi and Strange, 2007). Specifically, prior research indicates that contextual differences are elements that magnify the uncertainties and costs of doing business abroad, which some scholars called liability of foreignness (Hakanson and Ambos, 2010; Kostova and Zaheer, 1999; Slangen, 2011; Zaheer, 1995). Higher levels of uncertainty are linked to a lower likelihood of entering a particular location (Graf and Mudambi, 2005; Henisz and Delios, 2001). Although many studies have considered this line of research, the way these and other factors affect this decision is far from being fully explained. Some scholars point out that it is necessary to take into account firm characteristics that may alter it (Duanmu, 2012). Specifically, it is only in recent analysis of location choice that organizational and managerial aspects have been included (Duanmu, 2012; Lei and Chen, 2011; Lien and Filatotchev, 2015; Ramasamy, Yeung and Laforet, 2012). This paper addresses this issue by investigating whether the role of family involvement in ownership and management is a decisive factor in international location choice, by considering geographic and regulative distances.

Based on arguments from the resource-based view and agency and institutional theories, we explain that, when choosing locations, family firms and non-family ones may consider geographic and regulative distances differently. IB literature has analyzed geographic distance as a measure of the physical separation between two countries that implies costs and risks in terms of coordination, communication and monitoring problems (Baaij and Slangen, 2013; Slangen, 2011). We argue that these costs may be especially

important for family firms as they have limited resources and capabilities for assuming additional costs in international markets (Fernández and Nieto, 2006). Moreover, geographic distance may clash with the needs of family firms, such as maintaining control of the firm (Anderson and Reeb, 2003). Additionally, family firms have a competitive advantage when it comes to maintaining relationships with external stakeholders (Miller, Le Breton-Miller and Scholnick, 2008). However, social ties decline with increasing geographical distance, thus raising the cost of maintaining established relationships (Sorenson and Baum, 2003). Then again, geographic distance may hinder their options for exploiting this capability. Regarding regulative distance, which represents the difference between the levels of regulatory development of two countries, the literature has explained that entering a country for which this distance is greater may imply both difficulties and benefits. According to recent literature, regulative differences may be analyzed in terms of both the magnitude and the direction of the distance (Cuervo-Cazurra and Genc, 2011; Hernández and Nieto, 2015). Additionally, firms prefer to enter countries where regulations are better (Guler and Guillén, 2010). Nevertheless, the literature has posited that firms may develop “location capabilities” or a “sense of place” that allow them to extract value from that location (Zaheer and Nachum, 2011) and build an institutional advantage (Martin, 2014). Moreover, firms with specific characteristics may transform what existing literature and common sense consider disadvantages into advantages (Cuervo-Cazurra and Genc, 2008). Based on this reasoning, we suggest that a family firm may be more likely to develop a sense of place and an institutional advantage, and enter environments with lower levels of regulative development than its origin, when compared to non-family ones. Family firms have resources –such as autonomy in decision-making, relational capabilities and social capital– that are more useful in those countries. This may explain why, as a response to deficiencies in the

institutional and market environments, these firms have predominated in countries with underdeveloped formal institutions (Bertrand and Schoar, 2006; La Porta, Lopez de Silanes and Shleifer, 1999; Khanna and Palepu, 2000).

In order to test our hypotheses, we develop our empirical models using a database of Italian firms with more than 50 million euros in revenues operating internationally between 2000 and 2013, in which we examine the location decisions worldwide. This data includes information brought together from AIDA, the Italian branch of the Bureau van Dijk data provider, the Italian Chamber of Commerce and the Reprint data set. This database therefore provides information about individual characteristics, such as whether a company is a family firm or not and the locations in which they have invested.

The study contributes to the literature in several ways. In theoretical terms, on the one hand, we extend the international location choice literature by including firm factors in the analysis. With regard to this, we aim to fill in the gap identified in the literature on the relevance of interactions between internal firm characteristics and external factors in location choice (Alcacer, Dezsó and Zhao, 2014). Additionally, by analyzing geographic distance and a firm factor that may moderate its impact on internationalization decisions, we contribute to the call for more research into the effects of spatial distances (Baaij and Slangen, 2013; Beugelsdijk, McCann and Mudambi, 2010). Similarly, we extend the research of those papers by considering regulative distance to be a factor that should be analyzed in terms of both its magnitude and its direction, and call for the moderators affecting the distance–internationalization decision relationships to be examined (Hernández and Nieto, 2015). On the other hand, we broaden the literature on family firms and specifically respond to the need to know more about an internationalization decision such as market selection (Kontinen and Ojala, 2010). We then shed light on this

question by explaining some of the attributes of family firms that make them differ from other firm types or organizations in the way they consider geographic and regulative differences. Moreover, we explain that family firms respond differently to geographic and regulative distances, due to the different capabilities required for managing these different types of distance. Empirically, since we have data on Italian firms entering 49 host countries, we can extend the analysis of country choice from a global perspective. We therefore go beyond other studies that have focused on location choices within a single host country or region (Kuo and Fang, 2009; Lei and Chen, 2011; Lien and Filatochev, 2015; Ma *et al.*, 2013).

The structure of the paper is as follows. The next section reviews the existing literature on distances affecting location decision and family firm factors affecting internationalization strategy. We after develop our hypotheses. Then, we provide a detailed description of the data and the methodology applied. In the last part of the paper, we report on the empirical results and end with a discussion of these results and the conclusions we have drawn from them.

## **Theoretical Background**

### **Geographic and regulative distances in international location decisions**

One of the aspects examined in the international location decision literature is how host country factors, or the differences in these factors between origin and destination, affect this decision. These factors include market size, labor costs, human capital, institutional development and differences, country risk and geographic distance (Basile, Castellani and Zanfei, 2008; Graf and Mudambi, 2005; Guler and Guillén, 2010; Mataloni, 2011). The main reason for developing this line of research is that firms entering foreign

countries face the liability of foreignness, which may condition their choices. This liability can be summarized as those costs related to spatial distance and those related to the unfamiliarity with the host country derived from the differences between origin and destination, which can impact negatively on the performance and survival of the firm (Zaheer, 1995).

From a spatial point of view, geographic distance defines the degree of proximity between locations. According to the IB literature, geographic distance creates transaction costs, such as information asymmetries, monitoring and control problems and communication costs (Williamson, 1979). Moreover, it implies coordination problems derived from the greater complexity in exchanging knowledge (van Kranenburg, Hagedoorn, Lorenz-Orlean, 2014; Zaheer and Hernández, 2011), and in synchronizing activities due to time-zone diseconomies (Gooris and Peeters, 2014). Other costs derive from the differences between the institutional context of the origin and that of the destination. In this respect, special importance is attributed to those differences related to regulative differences. Traditionally, regulative distance has been seen as a factor that increases the uncertainty and difficulties the firm encounters in behaving according to the laws and regulations of the foreign country (Kostova, 1999). However, regulations have the special characteristic of being defined in terms of their development. Differences in regulations may therefore imply unfamiliarity with host markets but not necessarily more uncertainties. Firms may face different challenges depending on whether they are entering countries that are more developed or less developed in regulative terms (Coeurderoy and Murray, 2008; Hakanson and Ambos, 2010; Kim and Gray, 2008).

Overall, when entering a destination, firms have to consider whether they have the complementary resources, capabilities, relationships and/or social capital necessary to

deal with the difficulties that internationalization may imply (Cuervo-Cazurra, Maloney, Manrakhan, 2007). The literature has considered some of the firm factors that could moderate these difficulties. Aspects such as firm experience, size, productivity and ownership type may also affect the way some environmental dimensions influence international location decisions (Chen and Moore, 2010; Kahn and Henderson, 1992; Lien and Filatotchev, 2015).

### **Family firms' peculiarities in the internationalization process**

As family firms' literature posits, these firms present differences from other organizations regarding their goals, governance structures and strategies (Carney, 2005; Kotlar and De Massis, 2013; Miller, Le Breton-Miller and Lester, 2010). Specifically, the literature has employed different theories to show the differences between family and non-family firms when taking their internationalization decisions. The resource-based view claims that they have both advantages and disadvantages when operating internationally compared to non-family ones. On the one hand, family firms have unique competitive advantages such as stronger commitment to fulfill chosen strategies and a higher dedication of resources to overcome the drawbacks of the internationalization process (Mitter *et al.*, 2014; Sirmon and Hitt, 2003), better relationships with external stakeholders (Miller *et al.*, 2008), and can be financed at a lower cost (Anderson, Mansi and Reeb, 2003). On the other, however, they have also been described as having limited resources, such as restrictions in financial resources and less experience in international management (Graves and Thomas, 2008), which make family firms less likely to be involved in international operations (Fernández and Nieto, 2006). With respect to the agency theory, research is also inconclusive. On the one hand, it has been argued that family firms may better manage traditional agency costs, which can benefit their internationalization processes. These costs are described in terms of asymmetries in the information and

interests in the agent-principal relationship. As, in family firms, there is an overlap between the family and the business, they have been described as entities with superior monitoring capabilities to those whose shareholders are diffused (Filatotchev *et al.*, 2007). However, other conflicts between different groups or generations may emerge, thus creating other agency problems (Schulze, Lubatkin and Dino, 2001) such as principal-principal conflicts and family-specific agency costs –i.e., management entrenchment and nepotism.

Moreover, the economic interests of the firms are sometimes confused with other interests that are more family-related and emotional in nature and might alter the decision-making process (Gomez-Mejia *et al.*, 2007). Thus, family owners are not only concerned with financial returns, but also with other non-financial aspects of the firm that meet the family's affective needs, identity, or the perpetuation of family heritage (i.e., the socio-emotional wealth). Family firms have to face two types of risk. The first is business risk, related to the degree of profit variability, and the second is the risk of losing control of the firm (Anderson and Reeb, 2003). Family firms are risk averse when their socio-emotional wealth is threatened by a reduction in family control. In this case, family firms would prefer lower-risk internationalization strategies that guarantee them control over the firm. If, however, the survival of the firm is threatened by performance decline, family firms will be willing to assume greater risks, which will in turn incentivize long-term decisions such as internationalization (Fernández and Nieto, 2014).

All these peculiarities of family firms may explain why the external conditions affecting their creation, survival and growth may influence them in ways that are different when compared to other types of firms (Chang *et al.*, 2008). Specifically, these peculiarities may explain why they behave differently when it comes to their location

decisions. We suggest that family firms are different from non-family ones when they have to manage distances in their international location choices. In the following section, we integrate different theories in order to give a detailed explanation of the reasons why family involvement in the firm is a relevant factor in international location choices, taking into account geographic and regulative distances.

## **Hypotheses**

### **Geographic distance and family firms' location choices**

One of the factors affecting firms' decisions is related to physical remoteness or geographical distance. Although its importance has decreased in the last decades thanks to transportation and communication technologies, research still posits that it determines firms' decisions (Hakansson and Ambos, 2010; Kraus *et al.*, 2015; Nachum and Zaheer, 2005) and it is a central component of global strategy (Zaheer and Hernández, 2011). Specifically, when considering internationalization decisions, it is defined as a barrier to foreign direct investment (FDI) (Grisrud and Benito, 2005).

Several scholars posit that geographic distance hinders knowledge transfers, as knowledge tends to be circumscribed within a geographical domain and the quality of information flows may be damaged as geographic distance increases (van Kranenburg *et al.*, 2014; Zaheer and Hernandez, 2011). Moreover, geographic distance implies management problems (Malhotra, Sivakumar and Zhu, 2009). All these problems come from the existence of communication and travel costs (Ghemawat, 2001) and time zone diseconomies (Gooris and Peeters, 2014). Managing higher levels of geographic distance may be more difficult for family firms, as their resources for internationalization purposes are more constrained (Fernández and Nieto, 2006); they have less access to financial resources and qualified personnel (Claver, Rienda and Quer, 2009); and have a low degree of formalization and structuring of information collection and analysis (Tsang, 2002).

Additionally, geographic distance may also negatively affect social interactions and personal contacts (Campbell, Eden and Miller, 2012). Distance implies higher costs of maintaining relationships (Sorenson and Baum, 2003). This issue may be more critical for family firms as they are organizations that are considered to be sources, builders and users of social capital (Bubolz, 2001; Sirmon and Hitt, 2003). Because of network ties and social connections, family-managed firms outperform when they pursue a home regional strategy (Banalieva and Eddleston, 2011).

Lastly, greater geographic distances may imply more asymmetric information, greater risk of opportunism, more difficulties and costly conflicts (Kraus *et al.*, 2015; van Kranenburg *et al.*, 2014). Geographic distance also hampers the transmission of knowledge and increases both the difficulties involved in supervising employees and the costs of the lines of authority (Arregle, Beamish and Hennart, 2009; Boeh and Beamish, 2012). Family firms are particularly averse to the risk of losing control over their operations, and act in such a way as to maintain their decision-making power (Anderson and Reeb, 2003).

On the basis of the above reasoning, we argue that the costs and risks derived from greater geographic distance are more difficult for a family firm to bear than for a non-family firm. All in all, we posit in the following hypothesis that family firms consider the effect of greater geographical distance to be more negative than non-family firms do, when choosing their international locations.

*Hypothesis 1: Family firms are less likely to choose geographically distant countries than non-family firms are, when investing abroad.*

### **Regulative distance and family firms' location choice**

Regulative institutions determine a country's rules, laws, policies and governance systems, and may promote or restrict firm behavior (Scott, 2001). Countries differ in their formal institutions, which results in a regulative distance between each pair of locations, when considering home and host countries (Kostova and Zaheer, 1999). Traditionally, regulative distance has been considered to be a factor that hinders entry into a specific country. The argument behind this is that differences in regulations increase uncertainty because the firm lacks knowledge about the host country (Hutzschenreuter, Kleindienst and Lange, 2014). However, recent literature fine-tunes perceptions, showing that this relationship is not as simple as it has been described. The effect of the differences has to be considered not only in terms of the magnitude of the distance, but also in terms of the relative positions of the host and the home country (Cuervo-Cazurra and Genc, 2011; Hakanson and Ambos, 2010; Hernández and Nieto, 2015).

Firms face different challenges depending on whether they are entering countries that are more or less developed in regulative terms. The literature has recognized that weak regulations and governance systems may create higher levels of risk and increase the level of uncertainty associated with doing business, whereas political systems with predictable rules minimize these risks (Coeurderoy and Murray, 2008; Kraus *et al.*, 2015). We cannot, therefore, assume that the regulative distance has symmetric effects when firms enter more or less regulative-developed countries than their country of origin. Specifically, more risk and uncertainty is derived from countries with worse regulations. However, beyond these environmental variables we have to examine firm factors and resources that may also influence how they operate in foreign markets, and make some risky operations easier to manage (Berry, 2006). Additionally, not all locations have the same value to all firms, on the contrary, some firms may develop some location

capabilities that allow them to extract value from a location that others do not (Zaheer and Nachum, 2011). One of these factors is related to family involvement in the firm. Family firms differ from other organizations in their strategic processes and in the way host country conditions affect them (Chang *et al.*, 2008). Family firms may have specific capabilities that may allow them to perceive regulative distance in different ways when compared to non-family ones.

We argue that family firms may be more likely to operate in countries with higher levels of negative regulative distance than non-family firms. On the one hand, family firms are especially common in countries where formal institutions are weak, as a response to the lack of market mechanisms to assure effective management (La Porta *et al.*, 1999). In these countries, ownership rights tend to be concentrated in family groups (La Porta *et al.*, 1998; Young *et al.*, 2008). Specifically, family ownership –an internal corporate governance mechanism– emerges as a substitute for legal structures –which are an external governance mechanism– that do not work (Peng and Jiang, 2010). When they enter contexts of lower regulatory quality, family firms may exploit their relational capabilities –the capabilities that make them better-positioned to benefit from the favor of politicians and other networks than non-family firms (Bertrand and Schoar, 2006). In fact, in locations with institutional voids, social capital facilitates access to, and screening of, new business opportunities (Carney, 2005)

On the other hand, according to agency theory, when entering countries with lower regulative quality, family firms may exploit characteristics such as their autonomy in decision-making (La Porta *et al.*, 1999). They can take decisions without regard to internal and external accountability processes, they may arrange opportunistic investments to pursue opportunities that can only be rationalized by particularistic or

intuitive criteria and that other types of firms could not undertake (Carney, 2005). Moreover, they are considered to have superior monitoring capabilities when compared to firms with diffused shareholders, and these capabilities allow them to mitigate principal-agent conflicts (Miller, Minichilli, and Corbetta, 2013).

Overall, these firms, compared to non-family firms, may be more prone to develop a sense of place (Zaheer and Nachum, 2011) and an institutional advantage (Martin, 2014) in locations with lower levels of regulative development than their origin. On the other hand, in countries with better regulations there are mechanisms protecting shareholders that make alternative organizational forms possible and make family ownership irrelevant or even detrimental to acquiring more value from the context (Peng and Jiang, 2010). In these environments, which have more transparent and supporting institutions that protect minority shareholders, non-family firms may better exploit their ability to use external financial shareholders and experienced managers (Tihanyi, Johnson, Hoskisson and Hitt, 2003).

Thus, we posit that, as regulative distance becomes more negative (locations with lower levels of regulative development compared to their origins), family firms will be more likely to choose that location compared to non-family ones. Additionally, as regulative distance becomes more positive (locations with higher levels of regulative development compared to their origins), family firms will be less likely to choose that location than a non-family firm would. We therefore establish the following hypothesis:

*Hypothesis 2: Family firms are more likely to choose countries with greater negative regulative distances than non-family firms are, when investing abroad.*

## **Data and Method**

### **Sample**

We study the location choices of Italian firms operating in the manufacturing industries. We select those firms legally established in Italy that undertake at least one foreign direct investment in the period and have revenues of over 50 million euros. We use several sources to build the data set. First, accounting and financial data are retrieved from AIDA, the Italian branch of the Bureau van Dijk data provider. Then, we match financial data with governance information obtained from official public filings stored at the Italian Chamber of Commerce (Amore, Garofalo and Minichilli, 2014). Finally, we gather data on foreign investments from the Reprint Database (Mariotti, Mutinelli and Sansoucy, 2015), which lists information on foreign entries undertaken by large Italian firms worldwide. The Reprint Database is based on information obtained from the companies' annual reports and crosschecked with press releases, newspapers and company websites. The threshold of revenues of 50 million euros excludes small and medium firms and limits the sample only to large firms, thus assuring high availability of information about both the firm and the foreign entry. Furthermore, in accordance with IB literature (Hennart and Reddy, 1997), we study one single home country, in order to avoid biases due to the impact of home country national differences on the entry mode.

Moreover, we focus on large firms, since we study equity entry modes, and small firms may face constraints in terms of lacking the financial and managerial resources to run foreign direct investments. The time span of the analysis is 2000–2013. Accordingly, for a firm to be included in the sample, it must have undertaken at least one foreign entry during that period. Furthermore, the only countries included as location choices are those

that have received at least three foreign direct investments in the time window<sup>7</sup>. As a result, we obtain 751 foreign entries run by 382 different firms in 49 different countries, of which 289 investments are undertaken by 146 family firms and 462 are run by 236 non-family firms.

### **Model and variables**

In order to test the hypotheses, we employ the conditional logit model, as is typical in many location choice studies (Duanmu, 2012; Mataloni, 2011; Schmidheiny and Brülhart, 2011). Such a model assumes that the set of N available host countries is closed. In other words, the firm has a defined set of countries and each time it chooses from among these countries. Under this model's assumptions, if the firm chooses one country, then N-1 countries do not receive that specific foreign direct investment (Schmidheiny and Brülhart, 2011). Indeed, both academic literature and anecdotal accounts tell us that strategic decisions such as investments abroad require massive managerial and financial resources. Consequently, it seems more appropriate to us to assume that when a firm decides to make an investment in a given country, it restricts the choice to that country. This does not mean that the other countries are not possible destinations for *another* investment; it just means that they are not jointly available but, rather, they are mutually exclusive alternatives.

For each of the 751 foreign entries, we report 49 observations, i.e., one for each country in the sample. The dependent variable *Location chosen* takes value 1 when the country is the real destination and is 0 for the 48 remaining countries. From an economic

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<sup>7</sup> The reason for this choice will become clearer when we describe the model. Indeed, since we will adopt a conditional logit model, we consider that the firm chooses where to locate the foreign direct investment from among all the available countries in the sample. Consequently, if we were also to include those countries that are rarely the destination of investment, which would dramatically expand the number of observations and artificially inflate statistical significance.

point of view, the firm observes the characteristics of the 49 available countries –which will be the independent variables– and chooses one of them. The process is the same for each of the 751 location choices, resulting in a final sample of 36,799 observations. Finally, firms may run more than one foreign direct investment. It seems reasonable to assume that there are correlations between decisions made by the same firm. Therefore, we relax the assumption of independence across observations by computing standard errors clustered at the firm level. Finally, since it is not possible with these models to consider individual (i.e., firm) specific alone, we follow the existing literature (Duanmu, 2012) and interact the family firm variable with the country specific variables of interest, which are geographic distance and regulative distance.

Table 1 below provides the descriptions of the dependent variable and the independent and control variables.

[Insert Table 1 about here]

*Family firm.* We differentiate between family and non-family firms. The definition of family firms is not univocal in the literature. Indeed, some studies rely solely on family ownership measures (Anderson and Reeb, 2003), while others employ a combination of family ownership and management (Singla, Veliyath, and George, 2014). We adopt the most conservative view, namely that family members are both shareholders and managers of the firm. In particular, we build on previous research on Italian family firms (Miller *et al.*, 2013) that uses a 50 percent equity stake threshold to identify a family firm (25 percent if the firm is listed). Moreover, we also require that the family leader –i.e., the CEO, executive president or sole administrator, depending on the adopted governance structure– has to belong to the owning family. Therefore, if the family ownership meets

the requirements above and the firm leader is a family member, this variable takes value 1; otherwise, it is 0.

*Geographic distance.* We take this variable from the CEPII database. It is computed as the air distance between the home and host countries' capital cities, and is expressed in thousands of kilometers. Geographic distance is a proxy of some costs, such as transportation and communication costs. As a result, we expect a negative association between geographic distance and the probability of choosing the host country.

*Regulative distance.* We rely on the six governance indicators developed by the World Bank, namely: voice and accountability (VA), political stability (PS), government effectiveness (GE), regulatory quality (RQ), rule of law (RL), and control of corruption (CC). For every country in the sample, we subtract from each indicator the value for Italy –i.e., the home country– thus obtaining the relative indicators. Furthermore, since the differences in the indicators share high correlations, we can assume that there are latent factors that affect the six indicators. Through exploratory factor analysis, we determine that only one factor has an eigenvalue greater than 1 (5.134) and it encompasses each of the six dimensions. The Cronbach's alpha for the six items is 0.965, well above the standard minimum thresholds employed in factor analysis. As a result, we create the continuous factor *Regulative distance*. Positive (negative) values of this variable indicate that the host country has more (less) developed institutions than Italy. In general terms, we expect that firms prefer to locate their investments in countries with better institutional context.

We control for several dimensions that the literature has shown to be relevant in the setting of location choice. When a variable is time-varying, we insert the value of the year preceding the foreign investment, in order to assure causality.

*Cultural distance.* The greater the cultural distance between home and host countries, the greater the perceived uncertainty, so this should persuade firms to avoid culturally distant countries. To measure this distance we employ the indicators developed by Dow and Karunaratna (2006), which consist of five dimensions (language, religion, levels of industrial development, levels of education, and political systems). However, we argue that only the first two dimensions measure culture, while the last three refer more to institutional indicators that we already capture with the regulative distance factor. In order to test this argument, we conduct an exploratory factor analysis with the above-mentioned five dimensions. It emerges that two factors maximize the explained variance. The first one encompasses language and religion (Cronbach's alpha = 0.834), whilst the second underlies levels of industrial development, levels of education, and political systems (Cronbach's alpha = 0.602). We therefore employ the first of these factors to control for cultural distance between Italy and the host country.

*Market size.* One of the motivations that push firms to internationalize is the need to enter markets where they will be able to sell their products. Wealthier countries offer the opportunity to expand the consumer base, and thus should be preferred by firms. We consider this aspect by accounting for the host country's market size –i.e., the Gross Domestic Product (GDP). The GDP data come from the World Bank. Because of the right skewness of the distribution, the data are log transformed.

*GDP per capita.* Firms may also pursue an efficiency seeking strategy. When this is the case, firms wish to lower their production costs. From economic theories, we know that costs are related to nominal wages, which are also the prices firms pay to workers for doing their jobs. Labor cost reduction is, in fact, one of the main motivations behind internationalization. We measure it as the host country's GDP per capita in purchasing power parity (PPP) US dollars divided by 1000. The data come from the World Bank.

*Unemployment rate.* The unemployment rate measures the willingness of the population to enter the workforce. When the unemployment rate is high, firms have more bargaining power, and thus may pursue their efficiency seeking strategy more effectively. We control this aspect by including the host country unemployment rate. This data has been gathered by the World Bank.

*Tax rate.* The relationship between tax rate and location choice is not straightforward. On the one hand, it is commonly accepted that firms prefer countries with light taxation in order to maximize their net profits. On the other hand, taxes contribute to the development of both the physical (e.g. airports, ports, highways) and intellectual (e.g. human capital) infrastructures that foster the firm's productivity. Therefore, if tax revenues are misused, high tax rates might repel firms; conversely, if tax revenues are employed to improve the country's infrastructures, they can attract firms. The data on tax rates come from the World Bank.

*Country risk.* We rely on the classification developed by the OECD (2016), which lists countries according to both a quantitative and a qualitative risk evaluation and then assigns a risk factor that ranges between 0 (lowest risk) to 7 (highest risk). We would expect that firms avoid investing in riskier countries.

*Economic freedom.* A lack of economic freedom may discourage firms from investing in a given country. Indeed, when economic freedom is limited, expropriation, nationalization and restrictions on economic activities are more likely. We control this aspect by inserting the degree of economic freedom in the host country. This index, developed by the Heritage Foundation and the Wall Street Journal, ranges from 0 to 100 (it has been divided by 100 in the analyses in order to rescale it, and higher values indicate economically freer countries).

### **Descriptive statistics**

Table 2 reports the geographic distribution of foreign direct investment in the sample. We observe that China is the favorite foreign location for Italian firms, since it is the host country in 15.05 percent of the observations. France (8.79 percent), the United States (8.66 percent), and Germany (7.46 percent) follow it. Splitting the sample between family and non-family firms makes it possible to provide a rough test of the hypotheses. The two categories do indeed show a different distribution across countries. When we focus on geographic distance, we see that no huge difference emerges between the two samples. Let us consider four countries that are at significant distances from Italy: China (8,134 km), the United States (7,224 km), Brazil (8,913 km), and Mexico (10,254 km). We report that in two of these countries –i.e., China and Brazil– family firms’ share of investment exceeds that of non-family firms; the opposite is true for the United States and Mexico. This finding is not consistent with the idea that geographic distance is more detrimental for family firms’ location choices.

Family firms exceed their non-family counterparts in countries with poor institutions –compared to Italy– such as China (18.69 percent), Brazil (6.57 percent), India (4.15 percent), and Russia (3.81 percent). On the other hand, non-family firms invest in countries with stronger institutions than Italy, such as the United States (8.87 percent), Germany (7.79 percent), and the United Kingdom (6.71 percent). These descriptive statistics are in line with the idea that family firms prefer countries with lower levels of regulative development.

[Insert Table 2 about here]

Besides the geographic distribution, we test the difference across family and non-family firms in Table 3. Tests rely on the conservative two-tailed t-test. We observe that,

on average, family firms invest in countries that are, on average, 4,473 km away from Italy, which is slightly more than the distance chosen by non-family firms (4,263 km). However, the difference is not significant at any commonly accepted statistical threshold. Moreover, family firms invest in countries with a strongly significant lower regulative factor score (0.047) than their family counterparts (0.389). Moving to the controls, we report that family firms prefer more culturally distant countries, with a lower GDP per capita, higher tax rate, lower country risk, and less economic freedom.

[Insert Table 3 about here]

Table 4 reports the summary statistics of the whole sample and the correlation matrix. Family firms undertake 38.5 percent of the foreign investments. The average values of indicators for the countries in which the firms in our sample invest are: GDP per capita of 20.359 US dollars; unemployment rate of almost 8 percent; marginal tax rate of 26 percent; moderate country risk (2.759); and moderate economic freedom (65.345). However, as we have already reported in Table 3, there is a huge variation among host country characteristics; this variation is incorporated in the high values of the regressors' standard deviations. Unsurprisingly, correlation factors are noticeable in the sample. The reason lies in the fact that country indicators are strongly related to each other. For instance, it does not astonish us that countries with better institutions usually ensure higher levels of economic freedom for both domestic and foreign investors. However, economic freedom and the level of development of institutions –although correlated– measure two different dimensions of location choice. If we leave the (imperfectly) correlated variables in the model, we run the risk of inflating standard errors and hiding significant coefficients; if we remove one of them from the model, the resulting coefficients may be biased because of the endogeneity of the omitted variable. We check

this issue by computing the variance inflator factor (VIF), which is a test that detects whether correlation is detrimental to standard error inflation and, thus, significant. None of the individual VIF values exceeds the widely accepted threshold of 10. The mean VIF is 2.512, also below the related threshold of 6 (Hair *et al.*, 2009). Consequently, high correlations are not an issue in the econometric analyses.

[Insert Table 4 about here]

## **Empirical Results**

Table 5 lists the econometric results. Coefficients in conditional logit models have to be interpreted as the marginal probability of choosing a country with higher (lower) values of the given regressor. In model (1), we report only the control variables. In model (2) and (3), we add the geographic distance and the regulative distance, respectively. Model (4) tests the first hypothesis. The geographic distance variable, as expected, is negative and significant (coef. = -0.156; p-value < 0.001), meaning that firms avoid investing in geographically distant counties. The interaction term between Geographic distance and Family firm is not significant (coef. = 0.017; p-value = 0.600). We therefore do not find support for H1. Figure 1 depicts this effect. We see that, as geographic distance increases, the probability of choosing distant countries drops, whilst such probability is at a maximum for countries that are closest. The slope of the two curves is similar, with those of family firms (solid line) being slightly flatter, as suggested by the interaction term in Table 5. In model (5), we test H2. We note that regulative distance from the home country affects positively the choice of a given location (coef. = 0.660; p-value < 0.001). We report that the interaction term between Family firm and Regulative distance is significantly negative (coef. = -0.376; p-value = 0.002), as expected. This result corroborates H2. We plot the predicted linear probability in Figure 2 in order to show the

effect of being a family firm on location choice. It emerges that non-family firms (dashed line) are more likely to locate their investments in countries with a positive regulative distance to Italy –i.e., better institutions. On the other hand, family firms (solid line) more often choose countries where regulative distance is negative – i.e., with worse institutions. Finally, in model (6), we report the interaction terms testing H1 and H2. No difference emerges with regard to the findings of models (4) and (5).

With regard to controls, we analyze them in model (6). As expected, culturally distant countries are less preferred than the closer ones (coef. = -0.154; p-value = 0.001). Moreover, firms look for large markets that can sustain sales (coef. = 0.884; p-value < 0.001). On the other hand, the assumption that they search for host countries that permit efficiency-seeking strategies is confirmed. Indeed, they prefer countries with low average salaries (coef. = -0.064; p-value = 0.009) and high unemployment rates, although this is not significant (coef. = 0.001; p-value = 0.950). With regard to tax rate, we find that coefficient is positive and significant (coef. = 0.015; p-value < 0.001). This finding is coherent with the view that firms are not averse to paying higher tax rates, since the taxes should be used to develop physical and intellectual infrastructures. Finally, they prefer countries that are low risk (coef. = -0.027; p-value = 0.020) and have high scores in economic freedom, although the latter is not significant.

[Insert Table 5 about here]

### **Supplementary analyses**

*A different interpretation of regulative distance.* Many economic and institutional distances differ from geographic distance in the sense that, while the latter is always absolute, the former might not be. Indeed, geographic distance derives from geometry that assigns to the distance between two points a given value, called the norm. One of the

proprieties of the norm is that it has no direction: going from A to B or, alternatively, from B to A has the same norm. The same is not true for economic and institutional distances. Indeed, a growing body of literature (Shenkar, 2001) prefers to talk of differences rather than distances. With regard to regulative distance in this study, we move from this premise and hypothesize that the location choice preferences of family and non-family firms vary, depending on whether they go to countries with more or less developed institutions. However, previous research in family firm literature assumes that these firms would follow a gradual internationalization model, theoretically interpreting distances in term of proximity (Pukall and Calabrò, 2014). This means that family firms would choose locations without distinguishing the direction of the distance. Moving on from the premise of these previous studies, we consider here regulative distance as though it were an absolute distance. In other words, going to a country with a score  $k$  either higher or lower than the home country would have the same effect, i.e., they would be *equally distant*. We therefore create a new variable (*Absolute regulative distance*), which is the absolute value of the *Regulative distance* variable described above. We then replicate model (5) of Table 5, by substituting *Absolute regulative distance* for *Regulative distance*. For the sake of brevity, we omit the table and show the plot of predicted probabilities in Figure 3. Considering distance as an absolute value supports the hypothesis that family firms prefer to enter countries that are more similar. Indeed, as absolute regulative distance increases, family firms (solid line) are less likely to choose those countries, whereas non-family firms (dashed line) are more likely. However, we posit that the widely-held opinion that family firms are more conservative and prefer to stay “close to what they know” could be the result of a misconception of distance. As we have shown, when choosing a country, firms are not indifferent to the quality of the institutions. They take into account both the distance –i.e., the norm– and the direction –i.e., the sign.

*Robustness checks.* We test the robustness of the findings in two ways. First, we adopt a different conceptualization of family firms; second, we break the regulative distance down into its six determinants.

We have adopted a stringent definition of family firms, in the sense that we have required family members to be involved in both ownership and management. We now relax this definition by considering those that have a dominant family within their shareholders to be family firms, in line with previous studies (Miller *et al.*, 2013). The equity threshold is again 50 percent for unlisted firms and 25 percent for listed firms. We consider these firms to be family owned firms. The investments run by family owned firms now come to 75.90 percent, compared to 38.48 percent in the previous analyses, in which the family had to be active in both ownership and management. As a result, 570 of the 751 foreign direct investments can now be ascribed to family owned firms. However, no notable difference emerges in the econometric analyses (the results are available upon request). Indeed, although the significance is lower, family owned firms still prefer to invest in countries with worse institutions, whilst non-family firms are more likely to opt for those with better institutions. Moreover, as for the principal analyses, no difference emerges with regard to geographic distance.

In the second robustness check, we break down the Regulative distance into the six constituent items. Indeed, while both theory and explorative factor analysis suggest that we can consider the six dimensions to be a single factor, we want to investigate whether some heterogeneity emerges among them. We therefore insert each of the six dimensions into the model and interact it with the Family firm variable. The results are reported in Table 6. The base levels of the six dimensions always show a positive sign, as is the case for regulative distance as a whole. Moreover, with the exception of voice

and accountability, the coefficients are always significant. The interacted terms, which underlie H2, are always negative and strongly significant along the six models. We then confirm that, regardless of the regulative dimension investigated, family firms always prefer to invest in countries with worse institutions, whilst the opposite is true for their non-family counterparts.

[Insert Table 6 about here]

## **Discussion and Conclusions**

Although international location decisions have been extensively analyzed in the literature, many aspects related to firm characteristics remain unexplored. Our paper advances in this direction by studying the behavior of family firms when selecting foreign investment locations, with attention paid to two fundamental factors: the geographic and regulative distances between origin and destination countries. With arguments from the resource-based view, agency and institutional literatures, we propose that family firms are more likely to choose geographically closer countries as destinations for their foreign direct investments than are non-family firms. And for regulative distance, we postulate that family firms are more likely than are non-family firms to choose locations with lower levels of regulative development compared to their origins.

The empirical analysis to test our hypotheses is performed using a dataset of 751 entries of Italian family and non-family firms into 49 different foreign countries between 2000 and 2003. With respect to the first hypothesis, our results indicate that no significant differences exist between family owned and managed firms and non-family firms in terms of the likelihood of selecting locations that are geographically closer. This finding does not provide empirical support for Hypothesis 1. Indeed, the result is counterintuitive if

we take into account the conclusions reached by Banalieva and Eddleston (2011); these authors point out that family firms with family leaders enjoy an advantage when they concentrate their effort on their home regions. We find, however, that the behavior of family firms is similar to that of their non-family counterparts when selecting geographical locations for FDI. In short, geographic distance is not a factor that differentiates the location decisions of family and non-family firms. We feel that this finding could be due to various reasons. First, transport and communication costs (which may encourage firms to look for closer locations) are increasingly more manageable (i.e., less expensive), and information technology now offers increasing numbers of solutions (Nachum and Zaheer, 2005). Family firms are concerned with maintaining control over their international operations, but coordination is becoming ever easier, even when the geographical distance is great. And second, we are studying FDI decisions; some papers on the pace of the internationalization process show that family firms conform to the model of gradual internationalization put forward by the Uppsala School (e.g., Boyd, Goto and Hollensen, 2010; Claver *et al.*, 2009). The firms in our sample may already be at advanced stages of their internationalization processes and could consequently be selecting locations that are further away in both geographic and psychic terms than they chose in the initial stages, when the resource commitment was lower.

The results for the second hypothesis, on the impact of the regulative distance between origin and destination countries, reveal that family firms are more likely to choose locations with lower levels of regulative development than are non-family firms (i.e., locations at greater negative regulative distances, as postulated in Hypothesis 2). In contrast, non-family firms feel more comfortable investing in institutionally developed countries because they can take advantage of supporting institutions to establish more market-driven relationships. Thus, we can conclude that family firms are more likely than

non-family firms to select locations with less developed regulatory systems in which they are better able to maneuver and exploit their specific capabilities and characteristics. As Cuervo-Cazurra and Genc (2008) state, in these contexts they are able to turn disadvantages into advantages. In less favorable regulative environments, therefore, family ownership and management (acting as internal corporate governance mechanisms) emerge as substitutes for legal structures, which are poorly developed. These findings are in line with Lien and Filatotchev (2015) that study investment location decisions in different regions of China. Those authors show how large block shareholders (family and institutional investors) have a positive impact on the likelihood of investing in less explored and riskier areas of China.

Our research contributes to the international business literature in two ways. First, we add to the few works that include firm-specific characteristics to explain the international location decision (Kuo and Fang, 2009; Duanmu, 2012). We incorporate family involvement in ownership and management, providing a more comprehensive understanding of the factors that underlie this decision. Moreover, apart from taking firm ownership and management into account, we examine two key dimensions in the selection of international location: geographic distance and regulative distance between origin and destination countries. The conceptualization of regulative distance in asymmetric terms offers a wider and more critical picture of regulative development as a determinant of international decisions, as recent papers point out (Hernández and Nieto, 2015). Considering regulative distance in absolute terms –instead of in asymmetric terms– can lead to inconclusive results that do not correspond to the reality that firms are confronted with when choosing locations for foreign investment. Our study considers both negative and positive regulative distances, and shows that greater distances in one direction or the other have different consequences for family versus non-family firms.

With respect to the literature on family firms, we are adding to the growing number of papers that study the internationalization of these firms in order to cast light on the determinants of international location choice, a topic that has been neglected up to now (Fernández and Nieto, 2014). Despite the strategic nature of this decision in increasingly global contexts, few works have attempted to determine whether family firms and non-family firms differ in their choice of destination countries, and if so how they differ (one exception is Kahn and Henderson, 1992). Our study sets out to answer this question by considering whether geographic distance on the one hand, and regulative distance on the other, have different impacts on the location decisions of family firms. The institutional literature has shown the influence of the institutional contexts of home and host country on international strategies (Henisz and Swaminathan, 2008). These factors, however, have received scant attention in the family firm literature. Our findings make it possible to clarify how aspects related to institutional parameters affect the international strategic choices of family firms.

In terms of managerial implications, our results suggest that geographic distance emerges as an equally important factor in location choice for managers of both family firms and non-family firms. When searching for an international location, however, regulative distance is a differentiating factor for family-owned and managed firms. Our results indicate that the fact that a location has a lower degree of regulation than the origin country does not preclude a family firm from deciding to locate its investment there. Because of their specific capabilities, family firms are well-equipped to exploit institutional advantages in less developed regulatory contexts (Martin, 2014). Therefore, although geographic distance is a central component of global strategy, family firms should pay special attention to the cultural, institutional and other distances that more recent literature emphasizes (Zaheer and Hernandez, 2011).

This paper's principal limitations offer avenues for future research. In addition to ownership and family controls, future studies should examine dimensions such as the impact of family generations, the training and/or experience of family managers and other variables that may explain the behavior of different types of family firms. Moreover (and as already pointed out), our analyses are only performed on FDI decisions. Longitudinal studies that follow the internationalization of firms over time may offer a more comprehensive picture of location decisions from the very beginning of the process. Lastly, since we do not have any measure of performance at the investment level, we are not able to investigate whether family firms derive an advantage from their choice of country. Future research may explore this issue by taking into account the financial consequences of this location choice, relying on performance measures at the decision level.

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## Tables and Figures

Table 1. Description of the variables

Variable	Description	Source
Location choice	1 if the i-th country has been selected; 0 otherwise	Reprint Database
Family firm	1 if the family owns at least 50% (if unlisted) or 25% if listed of the firm <i>and</i> the firm's leader is a family member; 0 otherwise	AIDA (Bureau van Dijk) and Italian Chamber of Commerce
Geographic distance	Distance between home and host countries' capital cities	CEPII
Regulative distance	Factor variable	World bank (governance indicators)
Cultural distance	Factor variable	Dow and Karunaratna (2006) distance (religion and language factors)
Market size	Host country GDP (logarithm)	World bank
GDP per capita	Host country GDP per capita	World bank
Unemployment rate	Host country unemployment rate (%)	World bank
Tax rate	Host country tax rate (%)	World bank
Country risk	Host country risk score	OECD
Economic freedom	Host country economic freedom	Heritage Foundation and the Wall Street Journal

Note:

CEPII is the Centre d'Etudes Prospectives et d'Informations Internationales

OECD is the Organization for Economic Cooperation and Development

**Table 2. Geographic distribution of the sample**

Country	Non-family firm		Family firm		Total	
	No.	%	No.	%	No.	%
China	59	12.77	54	18.69	113	15.05
France	41	8.87	25	8.65	66	8.79
United States	41	8.87	24	8.30	65	8.66
Germany	36	7.79	20	6.92	56	7.46
Spain	30	6.49	17	5.88	47	6.26
Brazil	24	5.19	19	6.57	43	5.73
Poland	29	6.28	13	4.50	42	5.59
United Kingdom	31	6.71	8	2.77	39	5.19
India	13	2.81	12	4.15	25	3.33
Russia	13	2.81	11	3.81	24	3.20
Mexico	12	2.60	7	2.42	19	2.53
Canada	6	1.30	8	2.77	14	1.86
Turkey	7	1.52	7	2.42	14	1.86
Czech Republic	8	1.73	5	1.73	13	1.73
Belgium	8	1.73	4	1.38	12	1.60
Switzerland	10	2.16	2	0.69	12	1.60
Bulgaria	8	1.73	3	1.04	11	1.46
Argentina	8	1.73	1	0.35	9	1.20
Nederland	8	1.73	1	0.35	9	1.20
Portugal	8	1.73	1	0.35	9	1.20
Other countries	62	13.42	47	16.26	109	14.51
Total	462	100.00	289	100.00	751	100.00

Table 3. T-test about regressors' means

	Non-family firms	Family firms	Difference
Geographic distance	4.263	4.473	0.210
Regulative distance	0.389	0.047	-0.342***
Cultural distance	-0.200	-0.035	0.165*
Market size	27.509	27.337	-0.171
GDP per capita	25.333	18.779	-6.554***
Unemployment rate	7.777	7.988	0.211
Tax rate	22.716	27.698	4.982***
Country risk	3.144	2.637	0.507*
Economic freedom	67.921	64.528	3.393***

Note:

†  $p < 0.10$ , \*  $p < 0.05$ , \*\*  $p < 0.01$ , \*\*\*  $p < 0.001$

Table 4. Summary statistics and correlation matrix.

	Mean	Standard deviation	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	VIF
(1) Family firm	0.385	0.487										1.000
(2) Geographic distance	4.422	3.658	0.078									1.678
(3) Regulative distance	0.129	0.994	-0.100	-0.463								6.559
(4) Cultural distance	-0.075	0.980	0.069	0.138	-0.290							1.359
(5) Market size	27.379	1.439	0.010	0.240	0.165	0.133						1.557
(6) GDP per capita	20.359	16.749	-0.101	-0.381	0.907	-0.231	0.366					4.431
(7) Unemployment rate	7.937	4.182	-0.054	-0.364	0.039	-0.338	-0.377	-0.155				1.436
(8) Tax rate	26.498	15.897	0.093	0.382	-0.643	-0.037	0.171	-0.558	-0.099			2.011
(9) Country risk	2.759	2.968	-0.038	-0.285	0.160	-0.341	-0.315	0.092	0.177	-0.171		1.180
(10) Economic freedom	65.345	9.741	-0.072	-0.267	0.869	-0.086	0.088	0.766	-0.027	-0.804	0.039	3.911

Note:

Mean VIF is equal to 2.512

Table 5. Conditional logit models. Dependent variable: Location choice

	(1)	(2)	(3)	(4)	(5)	(6)
Geographic distance		-0.155*** (0.016)	-0.143*** (0.016)	-0.156*** (0.033)	-0.142*** (0.016)	-0.120*** (0.036)
Regulative distance			0.363** (0.131)	0.363** (0.131)	0.660*** (0.176)	0.701*** (0.200)
Family firm x Geographic distance				0.017 (0.033)		-0.030 (0.039)
Family firm x Regulative distance					-0.376** (0.122)	-0.423** (0.148)
Cultural distance	-0.098* (0.040)	-0.182*** (0.047)	-0.151** (0.047)	-0.151** (0.047)	-0.153** (0.047)	-0.154** (0.047)
Market size	0.708*** (0.042)	0.871*** (0.055)	0.883*** (0.056)	0.883*** (0.056)	0.884*** (0.057)	0.884*** (0.057)
GDP per capita	-0.020*** (0.004)	-0.050*** (0.006)	-0.064*** (0.009)	-0.064*** (0.009)	-0.064*** (0.009)	-0.064*** (0.009)
Unemployment rate	0.030** (0.009)	0.001 (0.011)	0.001 (0.011)	0.001 (0.011)	0.000 (0.011)	0.001 (0.011)
Tax rate	0.010*** (0.003)	0.016*** (0.004)	0.015*** (0.004)	0.015*** (0.004)	0.015*** (0.004)	0.015*** (0.004)
Country risk	-0.019 (0.012)	-0.026* (0.012)	-0.028* (0.012)	-0.028* (0.012)	-0.028* (0.012)	-0.027* (0.012)
Economic freedom	0.002 (0.005)	0.002 (0.008)	0.010 (0.009)	0.010 (0.009)	0.010 (0.008)	0.010 (0.009)
Foreign entries	751	751	751	751	751	751
Host countries	49	49	49	49	49	49
Pseudo R <sup>2</sup>	0.130	0.157	0.158	0.158	0.161	0.161
Likelihood ratio	765.370***	923.363***	931.305***	931.846***	948.591***	949.884***

Note:

Firm level clustered standard errors in parentheses

\*  $p < 0.10$ , \*  $p < 0.05$ , \*\*  $p < 0.01$ , \*\*\*  $p < 0.001$

Table 6. Robustness tests. Conditional logit models. Dependent variable: Location choice.

	(1)	(2)	(3)	(4)	(5)	(6)
VA	0.022 (0.151)					
Family firms $\times$ VA	-0.429*** (0.125)					
PS		0.593*** (0.130)				
Family firms $\times$ PS		-0.245* (0.131)				
GE			0.740*** (0.202)			
Family firms $\times$ GE			-0.391** (0.140)			
RQ				0.838*** (0.226)		
Family firms $\times$ RQ				-0.469** (0.153)		
RL					0.488** (0.168)	
Family firms $\times$ RL					-0.374** (0.132)	
CC						0.579*** (0.168)
Family firms $\times$ CC						-0.383*** (0.113)
Geographic distance	-0.165*** (0.017)	-0.151*** (0.016)	-0.140*** (0.017)	-0.142*** (0.016)	-0.146*** (0.017)	-0.149*** (0.016)
Cultural distance	-0.275*** (0.055)	-0.181*** (0.044)	-0.154** (0.048)	-0.145** (0.049)	-0.188*** (0.047)	-0.178*** (0.047)
Market size	0.880*** (0.057)	0.934*** (0.060)	0.877*** (0.057)	0.870*** (0.056)	0.873*** (0.055)	0.876*** (0.055)
GDP per capita	-0.042*** (0.007)	-0.063*** (0.008)	-0.066*** (0.009)	-0.060*** (0.009)	-0.057*** (0.008)	-0.062*** (0.010)
Unemployment rate	0.010 (0.011)	0.005 (0.011)	0.001 (0.010)	-0.000 (0.011)	0.001 (0.011)	-0.001 (0.011)
Tax rate	0.012** (0.004)	0.013** (0.004)	0.013** (0.004)	0.017*** (0.004)	0.015*** (0.004)	0.015*** (0.004)
Country risk	-0.016 (0.012)	-0.026* (0.012)	-0.023* (0.012)	-0.020* (0.012)	-0.029* (0.012)	-0.026* (0.012)
Economic freedom	0.033*** (0.007)	0.015* (0.009)	0.010 (0.009)	0.006 (0.009)	0.017* (0.008)	0.014 (0.008)
Foreign entries	751	751	751	751	751	751
Host countries	49	49	49	49	49	49
Pseudo R <sup>2</sup>	0.162	0.163	0.161	0.161	0.160	0.161
Likelihood ratio	955.126***	957.964***	948.561***	949.055***	940.577***	949.483***

Note:

Firm level clustered standard errors in parentheses

\*  $p < 0.10$ , \*  $p < 0.05$ , \*\*  $p < 0.01$ , \*\*\*  $p < 0.001$

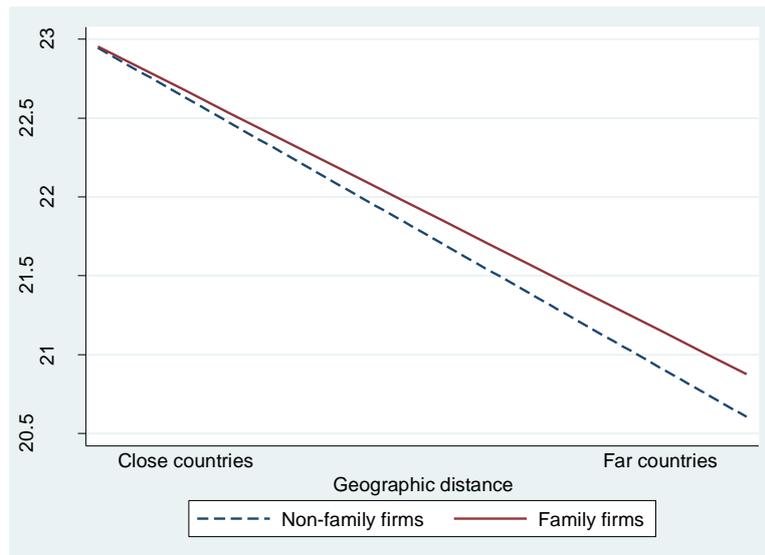


Figure 1. Predicted probability of location choice at various level of geographic distance for both family and non-family firms

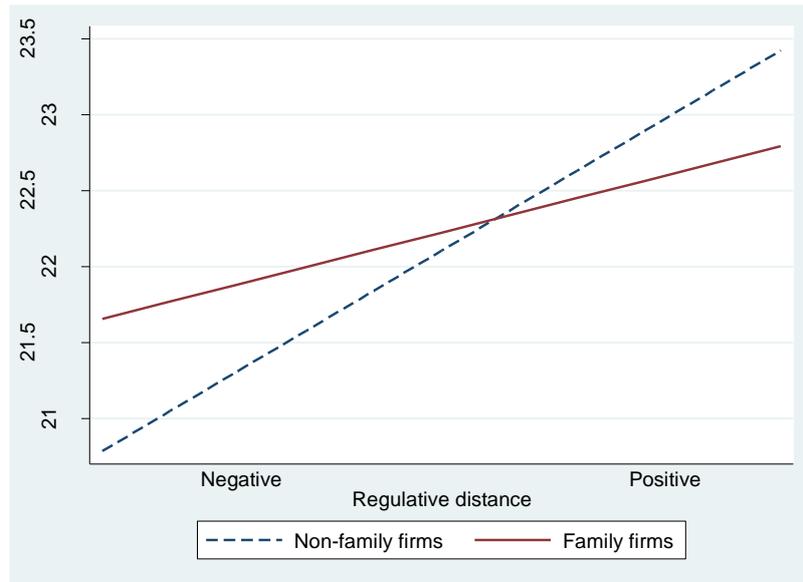


Figure 2. Predicted probability of location choice at various level of regulative distance for both family and non-family firms

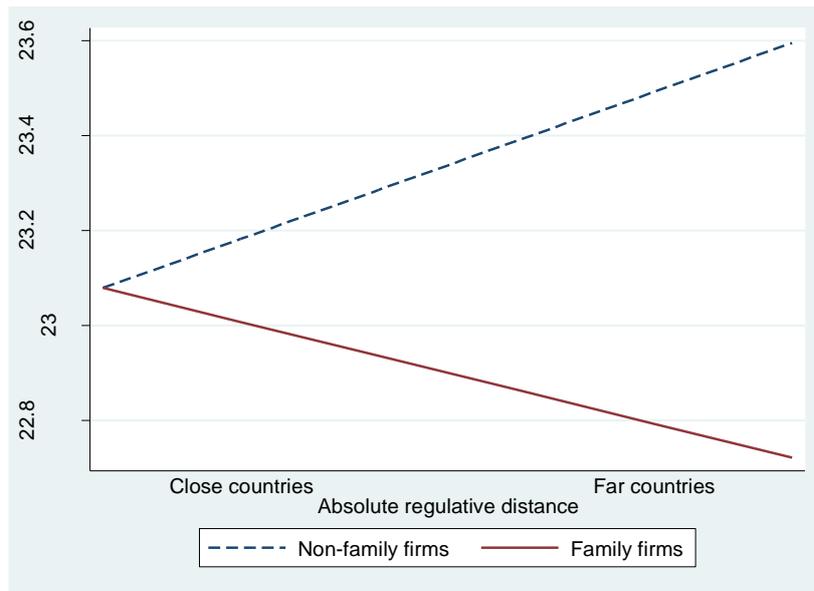


Figure 3. Predicted probability of location choice at various level of absolute regulative distance for both family and non-family firms



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**PAPER B. FAMILY INVOLVEMENT AND FIRMS' ESTABLISHMENT MODE  
CHOICE IN FOREIGN MARKETS**

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**ABSTRACT**

Extant literature on foreign entry increasingly recognizes firms' heterogeneity as a potential reason for inconsistency in results on the establishment mode choice, i.e., whether and under which conditions firms should choose to enter a new country through a greenfield investment or an acquisition. Our study contributes to this debate by identifying family ownership and family involvement in management as potential powerful sources of such heterogeneity. Integrating international business studies with both corporate finance literature on family firms and recent contributions from the Socio Emotional Wealth perspective on family ownership, we claim that, due to greater risk aversion and lower access to information, the family involvement either in the firm ownership and management leads to a higher propensity towards greenfield initiatives (vs. acquisitions). However, we also find that such a propensity decreases with international experience especially in family-owned firms given the greater ability of professionalized management to overcome family-related concerns on making acquisitions. Our analysis on 1,045 foreign initiatives undertaken by 311 Italian family and non-family firms between 2003 and 2013 confirms our expectations, indicating family ownership as a significant driver of firms' international strategies.



## **INTRODUCTION**

The literature on firms' entry into foreign markets has emphasized the importance of the establishment mode choice between a greenfield initiative and acquisition of an existing firm in the host market (e.g., Brouthers & Brouthers, 2000; Padmanabhan & Cho, 1999). Scholars applied several theoretical lenses, leading to a panoply of empirical findings and mixed conclusions about the role of several predictors (for a detailed review, see Slangen & Hennart, 2007). Within this context, firm heterogeneity, and specifically that related to corporate governance, can help shed further light on the issue (Strange, Filatotchev, Buck & Wright, 2009). In this paper, attention is devoted to the degree of family involvement in firm ownership and management. The significance of family business in modern economies is well documented in terms of both phenomenological and theoretical reasons. On the one hand, family firms (FFs) have been increasingly recognized as socially and economically dominant worldwide<sup>8</sup> (e.g., Gomez-Mejia, Makri, & Kintana, 2010). On the other hand, the literature acknowledges important differences in the strategies of FFs vs. non-FFs (e.g., Miller, Le Breton-Miller & Lester, 2010; Strike, Berrone, Sapp & Congiu, 2015), including internationalization choices (Fernández & Nieto, 2006).

We assert that FFs and non-FFs differ in their establishment mode choice abroad mainly relying on the following explanations. First, integrating contributions from the International Business (IB) framework, the Socio Emotional Wealth (SEW) approach (Berrone, Cruz & Gomez-Mejia, 2012), and corporate finance literature on FFs (e.g., Anderson & Reeb, 2003; Caprio, Croci & Del Giudice, 2011), we argue that the family

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<sup>8</sup> Family firms dominate not only in emerging economies, such as Asia (where they constitute approximately 95 percent of all firms), but also constitute 70 percent of all publicly traded firms in the US and almost half of the largest Fortune 1,000 firms.

includes the firm in its utility function, thus developing an international growth approach that is averse to risk and dilution of control. Second, FFs hardly possess or have access to the relevant information needed to reduce the uncertainty associated with entering a foreign market, while non-FFs benefit from the greater contributions of external financial and institutional shareholders and professional managers (Tihanyi, Johnson, Hoskisson & Hitt, 2003), who bring into the companies international experience gained in other firms, sectors, and markets. Third, distinguishing between family-managed firms (FMs), in which family members are simultaneously key owners and managers of the firm, and family-owned firms (FOs), in which the family dominates the shareholder base but managers are recruited externally (Chua, Chrisman, Steier & Rau, 2012), we argue that the presence of the family within management is associated with a lesser endowment of relevant information and experience and constrains the exploration of valuable options for expanding abroad.

Building upon these pillars, we claim that the greater the family involvement in the firm's governance is, the more likely that the firm will prefer less risky (more cautious) entry modes in foreign countries, i.e., greenfield initiatives rather than acquisitions. However, information gathered directly on foreign markets helps reduce firms' risk perception. This effect is particularly relevant for FFs and especially FOs in which talented non-family managers have a superior ability to extract information and knowledge from the firm's experience in foreign markets (Levy, Beechler, Taylor & Boyacigiller, 2007; Musteen, Datta & Herrmann, 2009). Accordingly, because of their greater understanding (and tolerance) of risk, FOs will expand their choice set, and more acquisitions will occur.

Consistently with this framework, we treat family ownership and management as exogenous, although there are theoretical reasons to expect that the relationship with the

establishment mode choice might be endogenous. First, the direction of causality might not be univocal. As a matter of fact, if a FF needs to issue fresh capital to finance an acquisition in order to survive, a family may decide to dilute its stake possibly losing control or even exiting the firm, thus turning the company into a non-FF. Likewise, for family management, when a FF requires professionalized managers to undertake an acquisition, family members may opt for leaving managerial positions – thus switching from being a FM to a FO. In both cases, the establishment mode choice would influence the family involvement in the firm, and not the other way round. Second, some unobserved factors may codetermine both family involvement and the establishment mode choice<sup>9</sup>. However, although we cannot solve the endogeneity problem, we believe this issue is likely less severe in our empirical context – i.e., in Italy – where, like in other European countries, family ownership and management exhibit high stability over time (Faccio & Lang, 2002; La Porta, Lopez-de-Silanes & Shleifer, 1999). Specifically, we consider Italian manufacturing firms with more than 50 million euros in revenue that undertook foreign entries in the period 2003-2013. As a result, we examine 1,045 foreign initiatives by 311 large Italian firms (Miller, Le Breton-Miller, Minichilli, Corbetta & Pittino, 2014).

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<sup>9</sup> For instance, let us consider the case of a technological change that makes the firm's family-specific assets outdated and no more effective to sustain the firm's competitive advantage on international market. On the one hand, this circumstance affects the family ownership since it may push the owning family to exit the firm, because their idiosyncratic competitive advantage is no longer exploitable. On the other hand, the firm has to access the resources needed to remain competitive through the acquisition of a foreign firm that incorporate the new technology.

We believe that, cross-fertilizing IB literature with the debate on management practices and sociological characteristics of family businesses, our paper provides novel ideas to explain previous controversial findings about the relationship between firms' heterogeneity and the MNE's establishment mode choice in foreign markets.

The paper is organized as follows. In the next section, we illustrate the establishment mode trade-off and discuss the characteristics of FFs that make them differently equipped to face the uncertainty inherent in any foreign initiative. We then develop our conceptual analysis of the moderating role of international experience in the relationship between family involvement and establishment mode choice. The third section presents our data set and describes the variables and the statistical models. The fourth section reports the econometric findings and some robustness checks, while the closing sections provide the discussion and some concluding thoughts on avenues of future research.

## **CONCEPTUAL FRAMEWORK AND HYPOTHESES DEVELOPMENT**

### **The establishment mode trade-off**

Under conditions of firms' liability of foreignness (Zaheer, 1995), the decision-making process regarding international growth is strongly affected by the market and event uncertainty characterizing the target countries, and benefits of internationalization may be difficult and costly to manage (Cumming, Knill & Syvrud, 2016). Thus, the establishment mode choice can be seen as a trade-off between the wish to effectively enter the market and access local complementary assets, which would lead to the acquisition of a local company, and the need to reduce financial and business risks, which would instead recommend more cautious greenfield investments. Indeed, entering a foreign market through a greenfield venture allows a company to replicate the existing organizational structure and reduce the uncertainty related to interactions with a

foreign company. Conversely, the acquisition of a local company constitutes the quicker way to access resources that are difficult to acquire via arm's length transactions, e.g. the foreign firm's knowledge base (Reiche, Harzing & Pudelko, 2015). However, acquisitions bring their own set of risks, mainly related to adverse selection and moral hazard relevant to the seller-acquirer relationship (Reuer & Ragozzino, 2014).

Several studies have investigated factors explaining how firms resolve the establishment mode trade-off and there is a call for further research on the topic (Hennart & Slangen, 2014). Among these factors, firms' heterogeneity has been held responsible for ambiguous results (Slangen & Hennart, 2007). Here, we consider the heterogeneity related to the role of family involvement in firm ownership and management.

### **Family firms' risk aversion and antidotes to uncertainty**

Recent advancements in family business studies revolve around the idea that what differentiates FFs from their non-FF peers is the orientation of family owners to pursuing economic and non-economic goals simultaneously. Reconciling predictions of agency and stewardship theories, the SEW approach offers a less normative view of managerial decision-making compared with classical economic models, in which economic and financial goals are balanced with family-centric social goals to preserve the stock of affect-related value that family owners have invested in the firm and to transfer the business to the next generation (Berrone et al., 2012). The deliberate purpose to combine economic and non-economic benefits of control and identification with the firm highlights a peculiar risk-bearing attitude in FFs. Specifically, when facing decisions conferring economic gains to the firm but at the expense of SEW, compared with alternative actions that would preserve SEW, family principals will likely prefer the latter (Strike et al., 2015).

Put differently, because families often freeze a large proportion of their financial and emotional wealth in the firm, they act to preserve the business, thus becoming significantly risk averse and refraining from actions that can jeopardize their investment, undermining the family business's trans-generational continuity (Faccio, Marchica & Mura, 2011). Furthermore, this risk aversion translates into families' resistance to every type of action that will potentially dilute their control of the firm (Caprio et al., 2011).

This attitude has relevant consequences for FFs' capital structure because families' behavior negatively affects the recourse to external equity and positively affects the use of internal funds (Koropp, Kellermanns, Grichnik, & Stanley, 2014). Indeed, corporate finance literature has found that FFs follow a growth strategy that is inherently cautious and relies on a proper mix of self-financing and debt financing. Specifically, while FFs use similar levels of debt as non-FFs (Anderson & Reeb, 2003), they have been found to be more prone to relying on internal rather than external funds (Caprio et al., 2011).

These financial decisions have relevant implications for the establishment mode choice in international operations. Being *a priori* averse to using external equity, when facing the opportunity to acquire a firm, FFs are often caught between two alternatives – debt or cash financing – both of which can have unpleasant side-effects. Indeed, debt-financed acquisitions can excessively increase financial leverage and bankruptcy probability (Furfine & Rosen, 2011), while cash-financed ones imply a high probability of future unwelcome sales of new equity needed to offset the cash takeover (Marynova & Renneboog, 2009). Consequently, FFs prefer greenfield investments that are more flexible and can be modeled gradually (Brouthers & Dikova, 2010), thus being less risky and more easily self-financed.

FFs' higher propensity to make greenfield investments is reinforced when considering their lesser ability to deal with the inherent uncertainty of foreign markets. In fact, FFs are likely not sufficiently endowed with the relevant antidotes – i.e., information and experience – because, compared with non-FFs, they lack or only marginally present external financial and institutional investors and professional managers that bring previous and contextual international experience and practices into the firm. This additional information and knowledge can help non-FFs understand the long-term implications of their internationalization strategic choices (Musteen et al., 2009) and appear essential to managing more risky foreign operations, such as complex acquisitions, effectively (Strike et al., 2015).

Altogether, risk aversion, SEW, and lack of information characterize FFs and constrain the set of strategic alternatives that they perceive and evaluate (Arregle, Naldi, Nordqvist, & Hitt, 2012). In this way, family involvement crucially influences the establishment mode trade-off in favor of greenfield investments, which are more consistent with the specific cognitive and emotional architecture of family principals<sup>10</sup>.

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<sup>10</sup> Even if a FF explores the opportunity to acquire a foreign firm, it will likely lose the competition on the international market for corporate control. Let us compare the competitive positions of two bidders, the focal FF and a non-FF. The more relevant information a firm has, the more correctly it assesses the risk of the acquisition. The non-FF is endowed with more information and is able to access and process further relevant information at lower cost.

Furthermore, because family principals concentrate their wealth in the single FF, they do not generally benefit from wealth changes tied to other diversified assets and therefore err on the right-hand side of the risk distribution (i.e., they do not rely on the mean risk but rather something higher). Under conditions of lower information, wealth concentration and risk aversion, the FF faces a higher discount rate in obtaining the deal price; then, the non-FF will

### **Family-owned versus family-managed firms**

It is worth taking into account that family presence is not a dichotomous condition because family may be involved to different extents in firm ownership and management. Accordingly, we distinguish between FMs and FOs (Miller et al., 2014; Singla, Veliyath & George, 2014).

First, it has been shown that the disclosure of firm activities is significantly lower in FMs than in FOs. Family managers leverage the higher degree of opacity to extract private benefits at the expense of minority shareholders (Anderson, Duru & Reeb, 2009). It is reasonable to assume that FMs' opacity raises buy-side constraints over equity issuance – in addition to the sell-side reluctance to dilute control outlined above. Therefore, external equity is likely more expensive for FMs because minority investors discount the risk of being expropriated by family managers due to the high opacity of these firms, making the use of self-financing comparatively cheaper. As already posited, self-financing is more suitable to funding greenfield investments because of its steadiness and incrementalism.

Moreover, the endowment of relevant information and expertise on foreign markets can differ significantly between the two categories of FFs. In FOs, external professional managers are more likely equipped with international experience that compensates for the inexperience of family principals (Menon & Pfeffer, 2003). Thus, hiring external

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incrementally outbid the FF, and the transaction will result in an acquisition for the non-FF. If this continues (or the market for existing opportunities dies), then the FF will be forced to simply make a decision whether to establish a project from scratch, and the set of strategic alternative will be consequently constrained. We are particularly grateful to an anonymous reviewer for suggesting such an interpretation, which strengthens our hypothesis.

managers helps overcome the risks associated with internationalization (Gomez-Mejia et al., 2010) and addresses a high degree of information asymmetry, thus promoting more acquisitions. In contrast, the overlap between family owners and managers that characterizes FMs will increase the non-economic concerns of decision-makers. In particular, nepotistic appointments of family managers selected from a small pool of family heirs will decrease the likelihood that they possess competencies comparable with those of professionalized non-family managers. This entrenchment effect (Bertrand & Schoar, 2006) exacerbates FMs' perception of risk in regard to establishment mode decisions.

Other features of FMs strengthen their orientation toward greenfields. First, core competencies in FMs are strictly embedded within the family boundaries, transmitted to the firm through the family's power and culture, and inclined to hew to path-dependent experience and traditions (Arregle et al., 2012). Because capitalizing on these idiosyncratic family-specific assets via acquisitions would require costly and risky integration with a local organization, FMs find it more suitable to enter a foreign country via a greenfield investment, which allows establishing the procedures and routines developed at home at a low marginal cost (Hennart & Park, 1993). Second, when managers are selected among family members, the identity, rather than the mere alignment of interests between owners and managers, is ensured (Miller et al., 2014). Indeed, family managers will mutually reinforce the family owners' wish to avoid riskier operations and eliminate traditional agency costs, as well as empire-building attitudes often characterizing external professional managers. Hence, an increasing degree of family involvement in leadership positions will further increase FMs' reluctance to make SEW-threatening investments.

Building upon the preceding arguments on non-FFs, FOs and FMs, we expect that the likelihood of expansion abroad through greenfield initiatives (rather than through the acquisition of pre-existing assets) increases with the degree of family involvement in the firm. Accordingly, our first hypothesis is as follows:

*Hp1. The likelihood of entering a foreign market through a greenfield initiative (vs. an acquisition) is higher for FFs than for non-FFs. Specifically, this is truer for FMs than for FOs, other things being equal.*

### **The moderating role of international experience**

Previous studies have shown that international experience reinforces a company's antidotes to uncertainty in foreign markets (e.g., Dow & Larimo, 2011). Specifically, a company's previous experience in a foreign market may reduce its liability of foreignness because the company learns how to deal with that country (Maitland & Sammartino, 2015), i.e., to interface with local formal and informal institutions, the workforce, and the like, thus mitigating risk aversion and the related propensity to prefer greenfield investments (vs. acquisition). In our context, we argue that experience gained in the host country affects the establishment mode choices of non-FFs, FOs and FMs differently.

While non-FFs are already well endowed with information stemming from the presence of experienced external actors in the firm, FFs will benefit comparatively enormously from the gathering of specific information on the foreign market. Thus, reduction of the relevant uncertainty will reduce FFs' propensity toward greenfield investments (more than that observed in non-FFs). However, when distinguishing between FOs and FMs,

we assert that the accumulation of specific international experience is likely to benefit the former even more. Indeed, thanks to their professionalization and previous complementary personal experience, FO managers are able to effectively absorb and transmit to family principals the information they lack and thus expand the firm's set of strategic alternatives<sup>11</sup>.

In contrast, FMs might be less able to integrate host country experience into their future decisions due to less talented family managers. Hence, the marginal effect of additional information on FMs' establishment choice is likely weaker than in the case of FOs.

Based on these arguments, we expect that the moderating role of specific international experience on the establishment mode choice is greater for FFs than for non-FFs.

However, FOs are more likely influenced than FMs, mainly because of the presence of external managers. Accordingly, we formulate the following hypothesis:

*Hp2. Host country experience negatively moderates the relationship between family involvement and the likelihood of entering through a greenfield initiative (vs. an acquisition). Specifically, this is truer for FOs than FMs, other things being equal.*

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<sup>11</sup> To better clarify the point, let us return to the example of competition on the international market for corporate control (see note 2). Thanks to their more talented managers, when information arrives, FOs update their assessment of the riskiness of acquiring the target firm in the host country. Acquisition target prices are now more in line with those of non-FFs, and bidding is more competitive because of the better understanding and tolerance of risk. As a result, more acquisitions occur. In other words, in comparison with non-FFs, FOs experiment a stronger (negative) marginal effect on their propensity to choose greenfield investments.

## METHODOLOGY

### Data set and summary statistics

To build the dataset, we use two secondary sources: the Reprint database, developed at Politecnico di Milano, which provides a census on foreign entries undertaken by Italian firms worldwide (Mariotti, Mutinelli & Sansoucy, 2015), and the Observatory AUB of Italian Family Businesses (Miller et al., 2014), developed at Bocconi University, which lists governance and accounting data on Italian FFs.

We focus on Italian firms operating at home in manufacturing industries<sup>12</sup> with more than 50 million euros in revenue (according to the European Union classification of large firms). The adoption of this threshold excludes smaller firms whose internationalization strategies might be *a priori* constrained by the lack of financial and human resources, thus distorting our analysis of the establishment mode choice.

Firms are classified into three categories: non-FF, FO and FM. In accordance with Miller, Minichilli, & Corbetta (2013), we distinguish between non-FFs and FFs, the latter being those firms that are controlled by one or two families with a 50% (if unlisted) or 25% (if listed) stake, or by an entity to which the above conditions apply<sup>13</sup>. Furthermore, FFs may or may not be managed by the owning family. It is common in FF literature to assume that a firm is family managed if the leader of the firm is a member of the owning family (Banalieva & Eddleston, 2011; Miller et al., 2013). We define the leader as the CEO, the executive chairman of the board or the managing

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<sup>12</sup> Firms operating in industries with 2-digit NACE codes from 10 to 33, according to the European Union classification of manufacturing firms.

<sup>13</sup> The choice of such high thresholds is justified because the Italian market for corporate control is characterized by large blockholdings (Miller et al., 2014).

director without a formal board of directors. If a family member holds one of these positions, we consider the firm a FM. Otherwise, we define the firm as a FO.

Regarding foreign entries, we consider all the operations abroad, excluding retail (i.e., stores and showrooms) because investments in retail activities are usually highly fragmented and complete information about them is difficult to collect. Specifically, we include all the equity-based operations, ranging from fully-owned subsidiaries to joint ventures and minority partnerships. In this way, we adopt a two-way classification of the entries by distinguishing greenfield investment from acquisition and controlling (majority) from non-controlling (minority) ownership, the latter being defined as the possession of a stake equal to or less than 50% in the foreign company.

By using the above criteria and after crossing the information between the two data sets to eliminate those records for which complete information on either the parent company or foreign entry is not available, we obtain a final dataset of 1,045 entries undertaken by 311 Italian firms in 63 foreign countries during the period 2003-2013.

Table 1 presents some statistics of the sample. Specifically, the lion's share (corresponding to 68%) of the total number of firms is constituted by FMs, which are responsible for 62% of the recorded foreign entries, FOs are 22% of the sample and account for 26% of the foreign initiatives, and the remaining is due to non-FFs<sup>14</sup>. On average, the sample firms have 768 employees and, notably, both FOs and FMs are larger than non-FFs, thus confirming the relevance of FFs in the Italian economy.

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<sup>14</sup> It is worth highlighting that the high share of FFs in our data set is not the result of a sampling bias but rather is a characteristic of the Italian economy, where FFs largely exceed their non-family counterparts.

As to the distribution between greenfields and acquisitions, it emerges that FMs prefer to establish ventures from scratch in 420 cases of 649 foreign entries (64.72%). This value is slightly lower for FOs (64.34%), while it significantly differs for non-FFs (31.45%), thus providing some preliminary evidence in favor of the first hypothesis. Regardless of the establishment mode chosen, it emerges that firms largely opt for majority investments rather than minority ones. When the investor decides to undertake a greenfield investment, it chooses to hold the majority of the equity stake in 562 cases of 634 (88.64%). There is no significant difference between FOs and FMs in this choice (89.14% vs. 89.76%), while non-FFs have a lower preference for maintaining control over the subsidiary (which occurs in 74.36% of the greenfield investments). Firms' preference for control also holds for acquisitions. Indeed, firms in our sample on average opt for controlling acquisitions in 364 of 411 cases (88.56%). FOs show a higher preference for majority acquisitions (95.88%), while FMs report 87.77% and non-FFs 82.35%. However, no significant difference emerges between the preferences for majority or minority investments conditional on the establishment mode chosen for every category.

*[insert Table 1 about here]*

Table 1 also shows that, on average, non-FFs undertake more foreign entries than their family counterparts (both FOs and FMs). Indeed, while the former undertake on average 4.28 foreign entries, the latter account for 3.94 and 3.05, respectively. Again, the main explanation resides with acquisitions because non-FFs show almost double the number of acquisitions per firm that FFs do. However, it is worth noting that the magnitude of this difference is contingent on the foreign context. Indeed, from the Observatory AUB of Italian Family Businesses, it emerges that non-FFs' average acquisitions per firm on the domestic market are only 1.15 times the average of FFs.

This descriptive evidence already provides some insights on the role of family control in firms' international growth. In particular, the exacerbation of the difference between the acquisition propensity of FFs and non-FFs in the international context is consistent with our interpretation grounded in the fundamental relationship between liability of foreignness, information costs and risk-aversion on the part of FFs. Furthermore, the declining number of foreign operations observed from non-FFs to FOs and FMs helps support our argument of a constrained choice set.

Likewise, to provide some preliminary evidence for our second hypothesis, we report the share of foreign entries in a given country that are preceded by at least one other investment in the same country in the previous years (starting from 2000) by the same firm. Table 1 shows that non-FFs have already entered the target foreign country in 45.16% of the cases. The share is definitely weaker for FOs and FMs, which account for 22.79% and 24.65%, respectively. When we condition this probability to the establishment mode, we see that non-FFs have comparable experience in the host country both when they opt for greenfield and when they select acquisition (43.59% vs. 45.88%). The result changes dramatically for FOs. Indeed, when FOs opt for acquisitions, they possess more host country experience (43.30%) than when they establish a venture from scratch (11.43%). This finding suggests that as FOs acquire experience in the host country, they are likely to prefer acquisitions and behave similarly to non-FFs. The impact of international experience on the establishment mode is also evident in FMs, although it is weaker than among FOs. Indeed, when FMs opt for greenfields, they are less likely to possess host country experience (17.86%), while this share is higher (37.12%) when they decide to acquire a foreign subsidiary.

Finally, we investigate whether there is any particular trend in the establishment mode conditional on the country entered. In Table 2, we present the foreign entry distribution

by country and the percentage of greenfield initiatives. It emerges that the share of greenfield investments is higher in developing and newly industrialized countries (e.g., China, India, and Russia), while acquisitions are more frequent in highly developed ones (e.g., the United States, the United Kingdom, and Germany). An explanation is that acquisitions are affordable in countries where there are plenty of established firms and a developed market for corporate control. We consider this aspect in the following regression analyses<sup>15</sup>.

*[insert Table 2 about here]*

### **Dependent variable**

To model companies' establishment mode choice, we consider a dummy variable (*Establishment mode choice*) that equals 1 when the focal entry is a greenfield initiative and 0 when it is an acquisition.

### **Explanatory variables**

To account for the involvement of the family in the parent company, we build three dummy variables. Specifically, *Non-family firm* is a dummy variable taking the value of 1 if the parent firm is a non-FF and 0 otherwise. It constitutes the base level of our analyses. Likewise, *Family owned* and *Family managed* take the value of 1 if the parent firm is a FO or a FM, respectively, and 0 otherwise.

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<sup>15</sup> As one reviewer notes, it seems that there, non-FFs avoid investing in certain countries. We investigate this issue by interacting FOs and FMs with each of the country-level controls, and no particular bias seems to emerge with reference to the object of this study. The results are available from the authors upon request.

The company's host country experience is measured by a count variable (*Host country experience*) that reflects the number of initiatives that a MNE has already undertaken in a given country at the time of the entry, starting from 2000. Doing so allows us to compute MNEs' host country experience also for the entries in the first years of the period considered (e.g., the year 2003).

### **Control variables**

To control for other factors that have traditionally been shown to influence MNEs' establishment mode choice, we add deal-, firm- and country-specific variables. When variables are time varying, they refer to the year preceding the foreign entry to ensure causality. A detailed description of the variables' operationalization and source is reported in Appendix 1.

#### *Deal-level controls*

The same firm can undertake greenfield or acquisition for different entries in the same or other host countries, depending on the motivation for the investment and the resulting need to access complementary assets (e.g., investments can refer to a new distribution location, a core manufacturing activity, a diversification of the firm's product portfolio, a backward/forward vertical expansion, and so on). Accordingly, we create four mutually exclusive dummy variables: *Expansion in services*, *Horizontal expansion*, *Vertical expansion*, and *Diversification*.

The probability of undertaking a greenfield investment decreases when the need for complementary assets in the host country increases. Complementary assets – such as tacit knowledge, specialized resources, and country-specific assets – may not be accessed via arm's length transactions. We expect that a firm's propensity to acquire rather than build is less pronounced in the case of expansion in services, the bulk of

which are sales, distribution, and marketing. With the exception of some downstream activities, such as customization and adaptation processes to address the specific needs of local customers, these services do not significantly require local complementary assets. Indeed, the acquisition propensity increases when a firm must expand its production along horizontal or vertical linkages or must operate in new industries because it cannot exclusively rely on internal competencies and resources.

*Firm-level controls*

*Parent size.* Parent size may have mixed effects on the establishment mode choice. On the one hand, larger firms may possess more idiosyncratic tangible and intangible resources, and greenfield investments facilitate these resources' exploitation abroad. On the other hand, larger firms are likely to possess more financial resources, allowing them to make heavy investments, such as acquisitions. *Parent age.* Older firms are more likely experienced in their business. We control for this generic experience, distinguishing it from specific international experience. *Parent diversification.* Firms domestically active in several industries may have developed skills and capabilities in sharing and integrating diversified complementary assets. Therefore, they may also be more inclined to acquire assets in foreign countries (Brouthers & Brouthers, 2000; Dow & Larimo, 2011). *Labor intensity.* Labor-intensive firms may prefer greenfield entries to acquisitions because post-acquisition integration costs can be very high due to over-employment problems (Siegel & Simons, 2010). *Listed.* Because we select a different threshold to detect family control in listed and unlisted firms (25% vs. 50%), we control for potential differences between them. *Leverage.* Firms with a high level of debt may be hindered in collecting the resources needed to expand abroad. Although this is true for every investment, acquisitions usually require a huge amount of money in a limited time span. For this reason, we expect that firms with a heavy financial structure will

find it more viable to enter through a gradual greenfield investment. *Cash flow on assets*. As a corollary to the previous rationale, firms that generate more operating cash flow must rely less on debt and find it easier to acquire foreign firms.

*Country-level controls*

*Psychic distance*. The greater the psychic distance is between home and host countries, the higher the perceived uncertainty is, thus pushing the parent company to opt for greenfield investments because they allow choosing from the outset the workforce, business routines, and other components (Hennart & Park, 1993). *Geographic distance*. The physical distance between home and host countries contributes to increase the firms' perceived uncertainty as well as the agency and transaction costs relevant to acquisitions (Malhotra & Gaur, 2013). *GDP growth*. In fast-growing markets, there is more room to absorb additional supply of goods (Brouthers & Brouthers, 2000). By definition, greenfield investments add extra capacity in the host market, while acquisitions do not. *GDP per capita*. Acquisitions may not be an option to enter developing countries, where a strong and diversified industrial structure does not yet exist. We control for this aspect by inserting the GDP per capita as a proxy for the host country development. *Market capitalization*. Acquisitions are more likely where a market for corporate control exists and is liquid. We then calculate the market capitalization over the GDP as a proxy for the market for corporate control development. *Time to start a new business* is a proxy for the difficulty of establishing a new firm in the host country. Other things being equal, the more that is required to start a new business, the higher the costs associated with a greenfield investment are. *Economic freedom*. Countries with low levels of economic freedom raise barriers to acquisitions (e.g., Padmanabhan & Cho, 1999).

## **Model**

Given the dichotomous nature of the dependent variable, we employ probit models to study the effect of the selected regressors on the likelihood of choosing a greenfield rather than an acquisition. We use a two-way fixed-effects model for the regression analyses. The first set of fixed effects refers to two-digit NACE code industry dummies in the sample (from 10 to 33), while the second accounts for each year of the foreign entry in the sample (from 2003 to 2013). Because many firms are responsible for several foreign entries in the period under investigation, it seems reasonable to assume that there exists a correlation among choices undertaken by the same parent company. Thus, we adopt firm-level clustered standard errors.

Furthermore, our sample confirms that in the Italian context family ownership and management are highly stable over time. Indeed, in the period 2003-2013, only 14 firms (4.50% of the sample) switched from being FFs (both owned and managed) to non-FFs and they are responsible for 71 foreign entries (6.79% of the total). Similarly, only nine FFs (2.89%) changed their leader, and they are responsible for 28 foreign entries (2.68%). Among the latter, seven FFs switch from a family leader to a non-family one. It is worth observing that, given the lack of significant changes in ownership and management structures, the Italian context is not appropriate to test whether the family involvement is endogenous.

## **RESULTS**

Table 3 shows the descriptive statistics of the dataset. In addition to the mean and standard deviation of the variables, we also report the pairwise correlations. Examining the correlations, none seems to suggest multicollinearity issues. To remove any doubt,

we compute the variance inflation factor (VIF). To reject the hypotheses that variables' correlations give rise to multicollinearity, each of the VIFs should be lower than 10, while the mean VIF should be lower than 6 (Hair, Black, Babin & Anderson, 2010). In the sample, neither threshold is violated, with the highest single VIF 5.74 (psychic distance) and mean VIF 2.19.

*[insert Table 3 about here]*

*[insert Table 4 about here]*

Table 4 presents the results of the regression analyses<sup>16</sup>. Model (1) includes only the control variables<sup>17</sup>. We first focus on the deal-level controls. We adopt *Expansion in services* as the base level. As expected, the three motivations considered – horizontal and vertical expansion and diversification – are negatively correlated with the propensity toward greenfield investments because these motivations imply proportionally more access to country-specific complementary assets than in the case of expansion in services. Acquisitions of local firms can be a more efficient way to access these assets. Examining the coefficients, not surprisingly, *Diversification* shows the highest difference from the base level, being associated with exploration strategies searching for new market and technology opportunities in sectors in which the firm is not active domestically (coefficient = -1.18; p-value < 0.05). *Vertical expansion* has the

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<sup>16</sup> We also specify the models without year fixed effects. The findings are comparable to those with such effects. Both the coefficients and marginal effects are reported in Appendix 2.

<sup>17</sup> The number of controls employed is high to rule out potential omitted variable endogeneity. However, we run additional models with varying numbers of controls to check the robustness of the results, and the main effects always hold. Sensitivity analyses with fewer controls are available from the authors upon request.

lowest difference (coefficient = -0.62; p-value < 0.05), while *Horizontal expansion* fits in the middle (coefficient = -0.84; p-value < 0.001).

Moving to the firm-level controls, *Parent size* positively influences the probability of choosing a greenfield investment, while the coefficients of variables approximating financial constraints do not come out significantly different from zero<sup>18</sup>. Finally, listed firms are keener to acquire. Possible explanations may reside in the fact that these firms are more used to operating in the equity markets and perhaps can benefit from knowledge externalities, being part of well-informed financial networks.

Concerning country-level controls, more developed countries favor the acquisition of local firms, as predicted. Analogously, although the related variable (*Market capitalization*) is not significant, countries with advanced markets for corporate control favor acquisitions. It is worth noting that psychic distance does not turn out to be significant, in line with previous studies (e.g., Brouthers & Brouthers, 2000; Padmanabhan & Cho, 1999) and some criticism about the constructs of this variable (Shenkar, 2001)<sup>19</sup>.

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<sup>18</sup> It may be worth noting that, to analyze whether financial constraints have different effects for FOs and FMs, we interact the relevant dummy variables with leverage and cash flow on assets; however, the interaction terms never come out significant. The results are available upon request.

<sup>19</sup> To correspond to the debate in the IB literature, we also employ the index proposed by Kogut & Singh (1988) and based on Hofstede's five dimensions of cultural distance. However, because the findings are similar in every model, we do not report the latter. Again, the results are available upon request.

In model (2), we test hypothesis 1. The model shows that both FMs and FOs are significantly more likely to make greenfield investments than non-FFs (that is the base level). The average marginal effects – reported in model (2) of Table 5 – suggest that FMs and FOs are 27% and 28% more likely to establish a greenfield than non-FFs, respectively (p-values < 0.001). However, there is no difference in greenfield propensity between FOs' and FMs' coefficients (p-value = 0.94), showing that family involvement in management, and the consequent idiosyncrasy of family-specific assets, has a minor impact, not sufficient to justify a further increase in the propensity to choose greenfield investments, with results indeed very high for both FOs and FMs compared with non-FFs<sup>20</sup>. Therefore, hypothesis 1 is partially supported.

*[insert Table 5 about here]*

Model (3) in Table 4 includes host country experience. Consistent with previous results (e.g., Dow & Larimo, 2011), the coefficient is negative and significant and the average marginal effects show that, when *Host country experience* increases by one, the likelihood of choosing a greenfield decreases by 2.44% (p-value < 0.05), as is apparent in model (3) in Table 5.

To test hypothesis 2, model (4) in Table 4 analyzes the interaction effects between family involvement and the parent's host country experience. Because the interpretation of the estimated results for the interaction terms is not as straightforward as for linear models (Ai & Norton, 2003), we rely upon graphical analysis as a supplementary

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<sup>20</sup> A complementary explanation relies upon the specific structure of control in Italian FFs, which exhibits high concentration, with families often acting as powerful blockholders (Miller et al., 2013). Under this condition, families can more closely monitor non-family managers through formal and moral suasion, thus easily aligning the firms' choices with their preferences.

method to coefficient testing (Hoetker, 2007). Additionally, because the findings could be invalidated if the groups have different unobserved heterogeneity, we also perform the Allison test (Allison, 1999) to avoid any potential interpretation error. The null hypothesis of the same unobserved variance is not rejected with a p-value of 0.90. Thus, we can compare the moderation terms.

*[insert Figure 1 about here]*

From model (4) in Table 4, it emerges that host country experience negatively moderates FOs' propensity to enter a foreign country through greenfield (coef. -0.24; p-value < 0.05); conversely, it does not show any significant effect on FMs. To clarify the point, Figure 1 depicts the average marginal effects of choosing a greenfield investment (y-axis) by FOs and FMs – relative to non-FFs – at various levels of host country experience (x-axis). We compute the marginal probability – relative to non-FFs – to establish a greenfield initiative between the minimum (0 previous entries) and the maximum (22 previous entries) values of *Host country experience*. Accordingly, FMs' propensity to make greenfield initiatives is 24.25% higher than that of non-FFs when both have no international experience. This greater preference holds stable along the entire range of host country experience, and it reaches 22.85% when both types of firms have 22 previous foreign entries in the same country. As predicted, the effect is stronger for FOs because they are 21.15% more likely than non-FFs to establish a greenfield investment when both have no previous experience (a percentage comparable to that of FMs). However, as the experience in the host country increases, it has an exacerbating effect on the propensity toward acquisitions, as long as they undertake 21.78% less greenfield initiatives than non-FFs when experience is at its maximum in our sample. To summarize, although a reduction in the noted propensity can be observed in all the firm categories when the host country experience increases, a large gap exists between

FOs and the other two categories, with the former definitely more sensitive to a variation in international experience. These differences are significant at any conventionally accepted statistical threshold, thus supporting hypothesis 2.

### **Robustness check on the role of the ownership choice**

To corroborate the results, we must rule out that the establishment mode choice is actually intertwined with the ownership choice in the foreign subsidiary and that the latter is inherently different for non-FFs, FOs, and FMs. In fact, relying on an international partner can be an effective way to share the risk of entry and obtain country-specific information and knowledge (Mariotti, Piscitello, & Elia, 2014). Thus, although joint ventures and other minority partnerships are viable both in acquisitions and in greenfield operations<sup>21</sup>, their influence on the establishment mode choice deserves to be investigated because the literature proposes opposing views: Hennart & Park (1993) argue that there is no relationship between the ownership and the establishment mode choices; other scholars (e.g., Kogut & Singh, 1988) suggest that such a relationship exists and should be properly taken into account.

Thus, we model the control and the establishment mode choice as a joint decision and create four combinations: *Acquisition & Minority*, *Acquisition & Majority*, *Greenfield & Minority*, and *Greenfield & Majority*, where minority (majority) means that the equity stake is lower than or equal to (higher than) 50%. The new dependent variable then takes four values, according to the mentioned classes, while the explanatory variables remain those illustrated in the previous section. The four classes cannot be ordered;

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<sup>21</sup> In our sample, the share of minority operations of the total is the same for greenfields and acquisitions (11.36% vs. 11.44% - Table 1).

however, they are mutually exclusive and exhaustive with regard to the aim of this work; therefore, we run multinomial logit with firm-level clustered standard errors. Econometric findings are reported in Table 6.

*[insert Table 6 about here]*

With no loss of generality, we choose *Greenfield & Majority* as the baseline model, meaning that estimated coefficients must be interpreted as deviations from the base level. In the first four columns of Table 6, we present the analyses that incorporate the standard controls, FO and FM (i.e., hypothesis 1). Examining the *Greenfield & Minority* column, we see that there is no significant impact of FO and FM. In other words, the impact of FO and FM does not change when the stake owned in a greenfield investment is a majority rather than a minority one. Similarly, both categories of acquisitions (i.e., *Acquisition & Majority* and *Acquisition & Minority*) are negatively influenced by family owned and family managed, thus showing that, regardless of the ownership choice, both FOs and FMs undertake fewer acquisitions (vs. greenfield) than non-FFs.

The last three columns of Table 6 also present the host country experience and its interaction with FO and FM (i.e., hypothesis 2). The base level is again *Greenfield & Majority*. When we compare the base level with *Greenfield & Minority*, we see that there is no difference in the main effects or in the interacted terms. Again, we can claim that FOs and FMs – also including their host country experience – do not behave differently according to the ownership choice in greenfield investments. Analogously, the interaction between FO and *Host country experience* is significant for both categories of acquisitions, while the interaction between FM and the latter is not. We

then find support for the main finding in hypothesis 2 and rule out that the ownership choice in a foreign subsidiary varies among non-FFs, FOs, and FMs<sup>22</sup>.

## **DISCUSSION**

Econometric findings support the arguments developed in this study. After controlling for deal-, firm- and country-specific variables that IB literature has shown to drive MNEs' establishment mode choice, we find that the latter is significantly influenced by the degree of family involvement in the firm. Consistent with our first hypothesis, FFs entering a foreign country are more prone to establish a new venture rather than acquire an existing company, compared with their non-family counterparts. However, contrary to our expectations, FMs do not behave differently from FOs in their likelihood of preferring greenfield investments. This result suggests that commonalities between FOs and FMs are significantly stronger than dissimilarities because SEW-driven risk aversion characterizes both typologies of FFs, and it plays a key role in orienting the choice of establishment mode in foreign markets.

Our results also confirm that, consistent with the traditional IB literature, the accumulation of information stemming from previous presence in the same country negatively moderates the need and propensity toward greenfield entries for all the typologies of firms. However, the marginal effects of host country experience increase in FFs, namely being stronger in FOs. We relate this effect to the different information

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<sup>22</sup> The Hausman-McFadden test on the irrelevance of independent alternatives (IIA) rejects the null hypothesis that omitting any category affects the ratio of the probabilities of choosing any pairs of alternatives, with a p-value lower than 0.01. Furthermore, no category can collapse to others because the Wald test is always significant with p-values lower than 0.01.

endowment that characterizes non-FFs vs. FFs. Non-FFs have a richer and more diversified shareholder and managerial base that *a priori* makes them well informed, so that additional international experience in the host country adds only marginally to their knowledge. In contrast, FFs lack solid international experience, and their perceived risk in acquiring abroad is higher, strengthening SEW worries about economic benefits of external growth decisions. Their risk aversion is mitigated only once they obtain specific international experience. However, FOs benefit more from this experience because their management is more equipped to absorb and leverage it. In FMs, in contrast, the absorption of specific international experience is inhibited or restrained by the lesser endowment of managerial capabilities, often exacerbated by the entrenchment effect.

Our results contribute to the academic debate about establishment mode studies (Hennart & Slangen, 2014) but also have implications for practice. Specifically, we suggest that FFs can suffer from specific features of family business that reduce and/or constrain their decision-making options. To better capitalize on their competitive advantages in foreign contexts, FFs must carefully balance the risk of SEW dilution and owner-manager misalignment with greater involvement in the firm of external investors and managers that give the firm access to new knowledge and experience and mitigate the entrenchment effect. Indeed, FFs may achieve several advantages from opening up their governance to non-family experienced actors, such as smoothing internal orientation biases, improving the ability to manage complex operations under uncertain conditions, and developing a willingness to pursue less conservative strategies that are more based on the combination of both exploitation and exploration activities (Patel & Chrisman, 2014).

## **LIMITATIONS AND FUTURE RESEARCH**

As usual, the paper is not immune from limitations that, still, provide opportunities for future research. First, although we are aware that linking managerial choices or decision models to measurable performance outcomes is critical (Brouthers, 2013), we do not address whether the selected establishment mode is the right or the wrong choice in terms of performance. Unfortunately, the lack of information about performance metrics relevant to foreign investment currently hinders such empirical extensions. However, in spite of several works on the establishment mode choice, we still know little about the consequences of this choice, and such an extension ranks high on our research agenda.

Second, allowing for the *ex-ante* heterogeneity of MNEs in terms of their parents' performances could provide additional hints. For example, Nocke & Yeaple (2007) show theoretically that cross-border acquisitions (compared with greenfield) involve either the most or the least efficient investing firms.

Third, the results on the relevance of host country experience encourage further investigation of its different components, especially the learning versus self-selection mechanisms associated with the repetition of successful/unsuccessful strategic choices, and related to either a specific host country or similar countries. However, and again, more detailed firm-level information would be needed, and its lack of availability currently hinders the noted avenues for development of the work.

We also acknowledge that family involvement is a broad and complex construct that is worth deep consideration. Thus, we call for more research on other facets of FF's heterogeneity, such as managerial structure and board of directors composition. Finally, although the Italian market is a particularly interesting context in which to study and compare FFs and non-FFs, the empirical setting can be fruitfully enlarged, e.g., by

adding more countries to test the role of country specificities and generalize the results. Indeed, although we built the sample carefully, the number of non-FFs in some countries' investments is limited due to the relatively minimal presence of these firms in the Italian context. We ran several tests to ensure that this paucity did not affect the empirical findings; however, it would be interesting to investigate whether the results hold in countries with a lower share of FFs. Furthermore, another limitation of the study concerns possible omitted variables that may influence both family involvement and the establishment mode choice, and the related difficulty in detecting the causality direction. Although the structural characteristics of our data do not allow to empirically assess whether family ownership is exogenous to the establishment mode choice, future research efforts should be devoted to disentangling endogeneity in FFs' internationalization strategies.

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**TABLES AND FIGURES**

**Table 1. Summary statistics.**

	non-FFs	%	FOs	%	FMs	%	Total	%
Firms (no.)	29		69		213		311	
Average size (no. of employees)	567		786		799		768	
Foreign entries (no.)	124	100.00	272	100.00	649	100.00	1,045	100.00
Greenfield	39	31.45	175	64.34	420	64.71	634	60.67
<i>Majority (&gt; 50%)</i>	29	74.36	156	89.14	377	89.76	562	88.64
<i>Minority (≤ 50%)</i>	10	25.64	19	10.86	43	10.24	72	11.36
Acquisition	85	68.55	97	35.66	229	35.29	411	39.33
<i>Majority (&gt; 50%)</i>	70	82.35	93	95.88	201	87.77	364	88.56
<i>Minority (≤ 50%)</i>	15	17.65	4	4.12	28	12.23	47	11.44
Average foreign entries per firm	4.28		3.94		3.05		3.36	
Greenfield	1.35		2.54		1.97		2.04	
Acquisition	2.93		1.41		1.08		1.32	
Share of foreign entries preceded by another investment in the same host country by the same parent firm (%)	45.16		22.79		24.65		26.60	
Greenfield	43.59		11.43		17.86		17.67	
Acquisition	45.88		43.30		37.12		40.39	

Table 2. Foreign entries distribution by country.

Country	non-FFs		FOs		FMs		Total	
	Foreign entries (no.)	Greenfield (%)						
China	21	66.67	28	89.29	103	76.70	152	77.63
United States	31	16.13	29	41.38	49	57.14	109	41.28
Germany	11	9.09	17	58.82	60	48.33	88	45.45
France	4	25.00	14	42.86	50	46.00	68	44.12
United Kingdom	11	9.09	24	29.17	33	51.52	68	36.76
India	1	100.00	13	76.92	36	83.33	50	82.00
Poland	8	50.00	4	50.00	28	78.57	40	70.00
Russia	5	60.00	14	85.71	19	94.74	38	86.84
Brazil	3	0.00	16	50.00	18	77.78	37	59.46
Spain	4	0.00	8	87.50	25	56.00	37	56.76
Switzerland	3	33.33	4	75.00	20	50.00	27	51.85
Hong Kong	1	100.00	5	100.00	20	75.00	26	80.77
Belgium	2	0.00	5	100.00	16	43.75	23	52.17
Netherlands	4	25.00	7	100.00	7	42.86	18	61.11
Austria	1	0.00	11	54.55	4	75.00	16	56.25
Portugal	1	0.00	2	50.00	12	58.33	15	53.33
Turkey	3	66.67	1	100.00	11	63.64	15	66.67
Other countries	10	40.00	70	68.57	138	68.12	218	66.97
Total	124	31.45	272	64.34	649	64.71	1,045	60.67

Table 3. Descriptive statistics (N=1,045).

	Mean	S.D.	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)	(15)	(16)	(17)	(18)	(19)	(20)
(1) Establishment mode choice	0.61	0.49																				
(2) Family owned	0.26	0.44	0.05																			
(3) Family managed	0.62	0.49	0.11	-0.76																		
(4) Host country experience	0.91	2.61	-0.23	-0.07	-0.16																	
(5) Horizontal expansion	0.44	0.50	-0.16	-0.14	-0.07	0.09																
(6) Vertical expansion	0.05	0.22	-0.04	-0.01	-0.05	-0.04	-0.20															
(7) Diversification	0.03	0.16	-0.09	-0.04	0.02	0.07	-0.04	-0.14														
(8) Parent size	5.79	1.80	0.10	-0.14	0.16	0.15	0.04	-0.02	-0.01													
(9) Parent age	38.06	29.29	-0.06	-0.01	0.13	0.11	0.01	-0.04	0.14	0.24												
(10) Parent diversification	1.62	0.89	0.01	0.14	-0.08	-0.06	0.00	-0.03	-0.09	-0.13	-0.26											
(11) Labor cost	0.19	0.25	-0.06	0.09	-0.04	-0.02	-0.05	-0.02	-0.01	-0.32	-0.04	0.14										
(12) Listed	0.35	0.48	-0.05	0.11	0.07	0.06	0.03	-0.21	-0.00	0.13	0.20	0.00	0.18									
(13) Leverage	1.19	5.21	0.06	0.07	-0.10	-0.04	-0.01	-0.01	-0.01	-0.06	-0.01	-0.02	-0.02	-0.04								
(14) Cash flow on assets	0.02	1.03	-0.02	-0.08	0.07	0.01	0.01	-0.02	-0.02	0.06	-0.02	-0.20	0.01	0.06	0.00							
(15) Psychic distance	1.60	1.65	0.22	-0.07	0.08	-0.08	-0.01	0.23	0.04	0.02	0.05	-0.04	0.02	0.01	0.03	-0.00						
(16) Geographic distance	8.03	0.95	0.14	0.02	-0.04	0.04	-0.03	0.14	0.04	-0.08	-0.01	-0.02	0.10	0.03	-0.01	-0.04	0.62					
(17) GDP growth	0.04	0.04	0.23	-0.04	0.06	-0.16	-0.02	0.15	0.04	0.02	-0.06	0.00	-0.00	-0.05	0.01	0.01	0.74	0.43				
(18) GDP per capita	9.48	1.35	-0.25	0.02	-0.06	0.15	0.02	-0.23	-0.02	-0.01	-0.02	-0.00	0.00	0.04	-0.03	-0.00	-0.58	-0.48	-0.68			
(19) Market capitalization	4.23	0.74	-0.03	-0.01	-0.01	0.09	0.03	-0.09	-0.05	0.03	0.01	0.02	0.07	0.04	-0.03	-0.01	-0.11	0.13	0.31	0.04		
(20) Time to start a new business	0.22	0.23	0.11	0.04	-0.02	-0.10	-0.02	0.11	0.02	-0.13	0.00	-0.01	0.01	-0.02	0.02	-0.08	0.43	0.31	-0.50	-0.22	0.29	
(21) Economic freedom	0.67	0.11	-0.19	0.01	-0.04	0.10	0.01	-0.19	-0.04	-0.02	-0.05	0.04	0.05	0.03	-0.03	0.01	-0.66	-0.24	0.18	0.42	-0.54	-0.54

Table 4. Probit models. Dependent variable: Establishment mode choice (greenfield = 1).

	(1)	(2)	(3)	(4)
<i>Main explanatory variables</i>				
Family owned		0.87*** (0.25)	0.74** (0.24)	0.65** (0.25)
Family managed		0.86*** (0.20)	0.72*** (0.19)	0.74*** (0.19)
Host country experience			-0.08* (0.03)	-0.05* (0.02)
<i>Interaction effects</i>				
Family owned x Host country experience				-0.24* (0.12)
Family managed x Host country experience				0.00 (0.05)
<i>Deal-level controls</i>				
Horizontal expansion	-0.84*** (0.12)	-0.72*** (0.12)	-0.73*** (0.12)	-0.73*** (0.12)
Vertical expansion	-0.62** (0.24)	-0.49* (0.21)	-0.54* (0.22)	-0.54* (0.22)
Diversification	-1.18* (0.58)	-1.11† (0.59)	-1.09* (0.54)	-1.08* (0.54)
<i>Parent-level controls</i>				
Parent size	0.08† (0.04)	0.08* (0.04)	0.09* (0.04)	0.10** (0.04)
Parent age	-0.00 (0.00)	-0.00 (0.00)	-0.00 (0.00)	-0.00 (0.00)
Parent diversification	-0.06 (0.08)	-0.07 (0.08)	-0.06 (0.08)	-0.04 (0.08)
Labor intensity	0.01 (0.22)	-0.06 (0.21)	-0.06 (0.21)	-0.08 (0.21)
Listed	-0.45** (0.17)	-0.56** (0.17)	-0.52** (0.17)	-0.52** (0.17)
Leverage	0.02 (0.02)	0.02 (0.02)	0.02 (0.02)	0.02 (0.02)
Cash flow on assets	-0.05 (0.04)	-0.03 (0.04)	-0.03 (0.04)	-0.02 (0.04)
<i>Country-level controls</i>				
Psychic distance	-0.00 (0.07)	0.01 (0.07)	0.01 (0.07)	0.01 (0.07)
Geographic distance	0.10 (0.07)	0.11 (0.07)	0.11 (0.07)	0.11 (0.07)
GDP growth	3.60 (2.26)	3.69 (2.27)	3.44 (2.26)	3.69 (2.30)
GDP per capita	-0.23* (0.10)	-0.21* (0.10)	-0.19* (0.10)	-0.19† (0.10)
Market capitalization	-0.03 (0.09)	-0.03 (0.09)	-0.01 (0.09)	-0.00 (0.09)
Time to start a new business	-0.05 (0.26)	-0.05 (0.27)	-0.07 (0.26)	-0.01 (0.26)
Economic freedom	0.25 (0.81)	0.34 (0.81)	0.04 (0.81)	0.16 (0.83)
Constant	1.68 (1.07)	0.62 (1.10)	0.38 (1.06)	0.21 (1.06)
Industry fixed effects	Yes	Yes	Yes	Yes
Year fixed effects	Yes	Yes	Yes	Yes
Observations	1,045	1,045	1,045	1,045
FO = FM (p-value)		0.94	0.90	0.61
Efron's pseudo R <sup>2</sup>	23.5%	25.5%	26.2%	26.9%
Ratio of correct classifications	71.96%	73.30%	73.40%	74.26%
Wald test <sup>a</sup>		19.52***	27.77***	40.08***
(degrees of freedom)		(2)	(3)	(5)

Note:

Firm-level clustered standard errors in parentheses

†  $p < 0.10$ , \*  $p < 0.05$ , \*\*  $p < 0.01$ , \*\*\*  $p < 0.001$

<sup>a</sup> Reference model is (1)

Table 5. Average marginal effects. Dependent variable: Establishment mode choice (greenfield =1).

	(1)	(2)	(3)	(4)
<i>Main explanatory variables</i>				
Family owned		0.28*** (0.08)	0.24** (0.07)	0.23** (0.07)
Family managed		0.27*** (0.06)	0.23*** (0.06)	0.24*** (0.06)
Host country experience			-0.02* (0.01)	-0.03** (0.01)
<i>Deal-level controls</i>				
Horizontal expansion	-0.26*** (0.03)	-0.22*** (0.03)	-0.22*** (0.03)	-0.22*** (0.03)
Vertical expansion	-0.19** (0.07)	-0.15* (0.06)	-0.16** (0.06)	-0.16** (0.06)
Diversification	-0.36* (0.17)	-0.34† (0.17)	-0.33* (0.15)	-0.32* (0.16)
<i>Parent-level controls</i>				
Parent size	0.02† (0.01)	0.02* (0.01)	0.03* (0.01)	0.03** (0.01)
Parent age	-0.00 (0.00)	-0.00 (0.00)	-0.00 (0.00)	-0.00 (0.00)
Parent diversification	-0.02 (0.03)	-0.02 (0.02)	-0.02 (0.02)	-0.01 (0.02)
Labor intensity	0.00 (0.07)	-0.02 (0.06)	-0.02 (0.06)	-0.02 (0.06)
Listed	-0.14** (0.05)	-0.17*** (0.05)	-0.16** (0.05)	-0.15** (0.05)
Leverage	0.00 (0.01)	0.01 (0.01)	0.00 (0.01)	0.00 (0.00)
Cash flow on assets	-0.02 (0.01)	-0.01 (0.01)	-0.01 (0.01)	-0.01 (0.01)
<i>Country-level controls</i>				
Psychic distance	-0.00 (0.02)	0.00 (0.02)	0.00 (0.02)	0.00 (0.02)
Geographic distance	0.03 (0.02)	0.03 (0.02)	0.03† (0.02)	0.03 (0.02)
GDP growth	1.12 (0.70)	1.12 (0.68)	1.03 (0.67)	1.10 (0.67)
GDP per capita	-0.07* (0.03)	-0.06* (0.03)	-0.06* (0.03)	-0.06* (0.03)
Market capitalization	-0.01 (0.03)	-0.01 (0.03)	-0.00 (0.03)	-0.00 (0.03)
Time to start a new business	-0.01 (0.08)	-0.02 (0.08)	-0.02 (0.08)	-0.00 (0.08)
Economic freedom	0.08 (0.25)	0.10 (0.25)	0.01 (0.24)	0.05 (0.25)
Industry fixed effects	Yes	Yes	Yes	Yes
Year fixed effects	Yes	Yes	Yes	Yes
<i>Observations</i>	1,045	1,045	1,045	1,045

Note:

Robust standard errors in parentheses

†  $p < 0.1$ , \*  $p < 0.05$ , \*\*  $p < 0.01$ , \*\*\*  $p < 0.001$

Table 6. Robustness checks. Multinomial logit models. Dependent variable in table header.

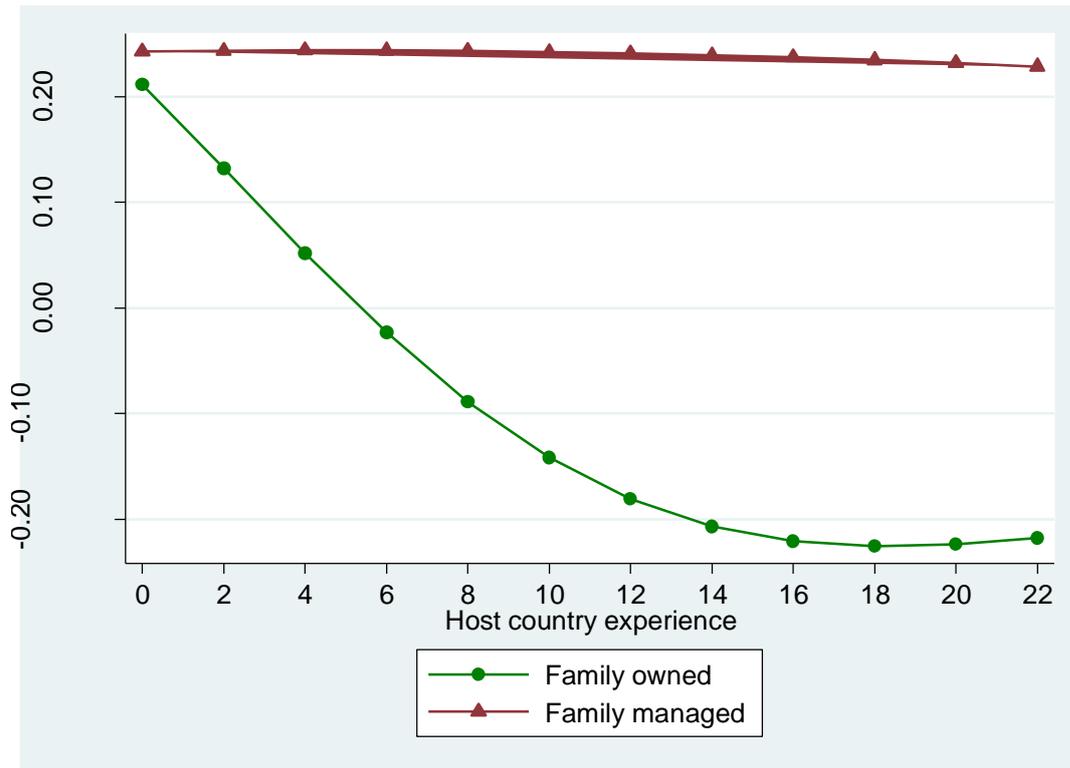
	Greenfield & Minority	Acquisition & Majority	Acquisition & Minority	Greenfield & Minority	Acquisition & Majority	Acquisition & Minority
<i>Main explanatory variables</i>						
Family owned	-0.36 (0.54)	-1.12* (0.44)	-3.06** (1.10)	-0.30 (0.54)	-0.93† (0.48)	-2.78** (1.07)
Family managed	-0.52 (0.53)	-1.14** (0.36)	-1.78** (0.57)	-0.52 (0.53)	-1.16** (0.36)	-1.78** (0.57)
Host country experience	0.20** (0.06)	0.17* (0.07)	0.17** (0.07)	0.07 (0.09)	0.11* (0.04)	0.08 (0.06)
<i>Interaction effects</i>						
Family owned x Host country experience				0.20 (0.27)	0.42† (0.25)	0.63* (0.31)
Family managed x Host country cluster experience				0.17 (0.11)	0.01 (0.10)	0.12 (0.13)
<i>Deal-level controls</i>						
Horizontal expansion	1.10** (0.34)	1.38*** (0.22)	1.41*** (0.43)	1.13*** (0.34)	1.38*** (0.22)	1.44*** (0.44)
Vertical expansion	1.43† (0.77)	1.03** (0.35)	1.37 (0.96)	1.41† (0.77)	1.02** (0.36)	1.38 (0.96)
Diversification	-0.14 (1.33)	2.07* (1.05)	0.36 (0.96)	-0.18 (1.34)	2.04† (1.06)	0.29 (0.91)
<i>Parent-level controls</i>						
Parent size	-0.01 (0.12)	-0.16* (0.07)	-0.26* (0.11)	-0.01 (0.12)	-0.17** (0.07)	-0.26* (0.11)
Parent age	0.00 (0.01)	0.00 (0.01)	0.00 (0.01)	0.00 (0.09)	0.00 (0.01)	0.00 (0.01)
Parent diversification	-0.08 (0.19)	0.13 (0.14)	-0.12 (0.37)	-0.10 (0.19)	0.11 (0.14)	-0.16 (0.40)
Labor intensity	0.72 (0.61)	0.12 (0.39)	1.02† (0.55)	0.73 (0.59)	0.14 (0.40)	1.02† (0.58)
Listed	0.08 (0.44)	0.99*** (0.29)	0.36 (0.72)	0.06 (0.44)	0.99*** (0.29)	0.35 (0.73)
Leverage	0.04** (0.01)	-0.02 (0.04)	-0.20 (0.18)	0.04** (0.01)	-0.01 (0.04)	-0.20 (0.18)
Cash flow on assets	0.15 (0.11)	0.06 (0.07)	0.15 (0.34)	0.14 (0.11)	0.05 (0.07)	0.15 (0.37)
<i>Country-level controls</i>						
Psychic distance	0.43 (0.27)	-0.04 (0.12)	0.32 (0.21)	0.43 (0.28)	-0.03 (0.12)	0.33 (0.21)
Geographic distance	-0.02 (0.22)	-0.16 (0.13)	-0.32 (0.35)	-0.02 (0.22)	-0.15 (0.13)	-0.31 (0.35)
GDP growth	-3.56 (7.52)	-5.75 (4.13)	-11.11 (6.99)	-4.08 (7.84)	-6.12 (4.19)	-12.14† (7.15)
GDP per capita	0.07 (0.33)	0.36† (0.19)	0.12 (0.28)	0.07 (0.34)	0.36† (0.19)	0.10 (0.28)
Market capitalization	0.31 (0.30)	0.02 (0.16)	0.20 (0.29)	0.31 (0.30)	0.02 (0.16)	0.20 (0.29)
Time to start a new business	-0.35 (0.96)	0.28 (0.47)	-1.93† (1.17)	-0.36 (0.97)	0.20 (0.47)	-2.09 (1.30)
Economic freedom	2.13 (3.21)	0.25 (1.48)	-1.49 (2.32)	2.22 (3.23)	0.03 (1.50)	-1.61 (2.37)
Constant	-4.09 (3.06)	-1.41 (1.97)	-12.30** (3.920)	-4.06 (3.11)	-1.18 (1.97)	-11.85** (4.00)
Industry fixed effects	Yes	Yes	Yes	Yes	Yes	Yes
Year fixed effects	Yes	Yes	Yes	Yes	Yes	Yes
Observations	1,045	1,045	1,045	1,045	1,045	1,045

Note:

Firm-level clustered standard errors in parentheses

† $p < 0.10$ , \* $p < 0.05$ , \*\* $p < 0.01$ , \*\*\* $p < 0.001$

Figure 1. Average marginal effects on Greenfield probability of family-owned and family-managed firms at various levels of host country (base level is non-family firms).



## APPENDICES

### Appendix 1. Controls description

#### *Deal-level controls*

We collected and cross-checked information from different sources: Zephyr–Bureau van Dijk database (4-digit industry codes of parent companies and relevant subsidiaries), annual reports, and other companies' releases. Accordingly, we built the following four mutually exclusive categories (and the related dummies):

- *Expansion in services*, i.e., investments in forward and backward service activities, such as sales & marketing, maintenance & servicing, technical support, logistics & transportation, and other services related to the core activity of the firm;
- *Horizontal expansion*, i.e., investments in the same manufacturing activities of the parent firm;
- *Vertical expansion*, i.e., investments in activities that are vertically (backward or forward) related to the parent firm's manufacturing activities; this category refers both to production in manufacturing, extraction, energy and construction and to functions strictly related to production, i.e., design, development & testing, and research & development;
- *Diversification*, i.e., investments in activities that are new to the parent firm.

#### *Firm-level controls*

*Parent size*. We measure the parent's size with the logarithm of the parent's number of employees. *Parent age* is measured by the difference between the year of the foreign entry and the parent's foundation year. *Parent diversification* is operationalized by counting the number of 4-digit industry codes in which the parent is active. *Labor intensity* is the ratio between the aggregate expenses for employees and the revenues of the firm; we log-transform it because of the log-normality of the distribution. *Listed* is a

dummy variable taking the value 1 when the parent firm is listed and 0 otherwise. The variable *Leverage* is the ratio between the parent firm's debt and common equity. *Cash flow on assets* is the operating cash flow divided by the total assets to rescale it. All the firm-level data come from the AIDA–Bureau van Dijk database.

#### *Country-level controls*

To measure the *Psychic distance* between Italy and the host countries, we adopt the Dow & Karunaratna's (2006) indicator, which encompasses five dimensions (languages, religions, levels of industrial development, levels of education, and political systems):

$$Psychic\ distance = \frac{1}{5} \sum_{k=1}^5 \frac{(I_{ijk})^2}{Var(k)}$$

where:

$I_{ijk}$  is the distance between country  $i$  (i.e., Italy) and country  $j$  (with  $j=1, \dots, 63$  host countries) for the  $k$ -th dimension; and  $Var(k)$  is the variance of the  $k$ -th dimension and aims to normalize for scale and heterogeneity across dimensions.

We collect *Geographic distance* between Italy and the foreign countries' capital cities from the CEPII database. Because of right-skewness of the distribution, the variable is log-transformed. *GDP growth*, *GDP per capita* and *Market capitalization* data come from the World Bank databases. *Time to start a new business* is the number of calendar days needed to complete all the required procedures to establish a firm. This number is then divided by 100 to rescale it. Data come from the World Bank's Doing Business database. *Economic freedom* is an index, developed by the Heritage Foundation and the Wall Street Journal, ranging from 0 to 100 (it has been divided by 100 in the analyses to rescale it). Higher values indicate economically freer countries.

Appendix 2. Probit models (coefficients and average marginal effects). Dependent variable: Establishment mode choice (greenfield = 1)

	Coef.	Marginal effects						
<i>Main explanatory variables</i>								
Family owned			0.86*** (0.24)	0.28*** (0.07)	0.74** (0.24)	0.24** (0.07)	0.64** (0.24)	0.24** (0.07)
Family managed			0.85*** (0.19)	0.28*** (0.06)	0.72*** (0.19)	0.23*** (0.06)	0.74*** (0.19)	0.24*** (0.07)
Host country experience					-0.08* (0.04)	-0.02* (0.01)	-0.05* (0.02)	-0.03** (0.01)
<i>Interaction effects</i>								
Family owned x Host country experience							-0.25* (0.12)	
Family managed x Host country experience							0.00 (0.05)	
<i>Deal-level controls</i>								
Horizontal expansion	-0.84*** (0.11)	-0.26*** (0.03)	-0.72*** (0.11)	-0.22*** (0.03)	-0.73*** (0.12)	-0.22*** (0.03)	-0.73*** (0.12)	-0.22*** (0.03)
Vertical expansion	-0.61* (0.24)	-0.19** (0.07)	-0.47* (0.21)	-0.14* (0.06)	-0.53* (0.22)	-0.16* (0.07)	-0.53* (0.22)	-0.16* (0.06)
Diversification	-1.16* (0.55)	-0.36* (0.17)	-1.09† (0.56)	-0.33* (0.17)	-1.06* (0.51)	-0.32* (0.15)	-1.05* (0.52)	-0.31* (0.15)
<i>Parent-level controls</i>								
Parent size	0.09* (0.04)	0.03* (0.01)	0.09* (0.04)	0.03* (0.01)	0.10** (0.04)	0.03** (0.01)	0.10** (0.04)	0.03** (0.01)
Parent age	-0.00 (0.00)							
Parent diversification	-0.07 (0.09)	-0.02 (0.03)	-0.08 (0.08)	-0.02 (0.03)	-0.07 (0.08)	-0.02 (0.02)	-0.05 (0.08)	-0.01 (0.02)
Labor intensity	0.06 (0.20)	0.02 (0.06)	0.01 (0.20)	0.00 (0.06)	-0.01 (0.20)	-0.00 (0.06)	-0.04 (0.20)	-0.01 (0.06)
Listed	-0.48** (0.17)	-0.15** (0.05)	-0.59*** (0.17)	-0.18*** (0.05)	-0.55*** (0.17)	-0.17*** (0.05)	-0.54*** (0.17)	-0.16** (0.05)
Leverage	0.02 (0.02)	0.01 (0.01)	0.02 (0.02)	0.01 (0.01)	0.02 (0.02)	0.01 (0.01)	0.02 (0.02)	0.00 (0.01)
Cash flow on assets	-0.04 (0.04)	-0.01 (0.01)	-0.02 (0.04)	-0.01 (0.01)	-0.02 (0.04)	-0.01 (0.01)	-0.01 (0.04)	-0.00 (0.01)
<i>Country-level controls</i>								
Psychic distance	0.00 (0.07)	0.00 (0.02)	0.01 (0.06)	0.00 (0.02)	0.02 (0.06)	0.01 (0.02)	0.02 (0.06)	0.00 (0.02)
Geographic distance	0.09 (0.07)	0.03 (0.02)	0.10 (0.07)	0.03 (0.02)	0.10 (0.07)	0.03 (0.02)	0.10 (0.07)	0.03 (0.02)
GDP growth	3.08† (1.76)	0.96† (0.55)	3.40† (1.79)	1.04† (0.54)	2.74 (1.79)	0.83 (0.54)	3.19† (1.78)	0.95† (0.53)
GDP per capita	-0.25* (0.10)	-0.08** (0.03)	-0.23* (0.10)	-0.07* (0.03)	-0.21* (0.10)	-0.06* (0.03)	-0.21* (0.10)	-0.06* (0.03)
Market capitalization	-0.00 (0.08)	-0.00 (0.03)	-0.01 (0.09)	-0.00 (0.03)	0.01 (0.08)	0.00 (0.03)	0.02 (0.09)	0.00 (0.03)
Time to start a new business	-0.08 (0.25)	-0.02 (0.08)	-0.06 (0.25)	-0.02 (0.08)	-0.08 (0.25)	-0.02 (0.08)	-0.01 (0.25)	-0.00 (0.08)
Economic freedom	0.25 (0.79)	0.08 (0.25)	0.36 (0.80)	0.11 (0.25)	0.06 (0.80)	0.02 (0.24)	0.17 (0.82)	0.05 (0.25)
Constant	1.85† (1.05)		0.74 (1.07)		0.52 (1.03)		0.34 (1.03)	
Industry fixed effects	Yes							
Year fixed effects	No							
Observations	1,045	1,045	1,045	1,045	1,045	1,045	1,045	1,045
FO = FM (p-value)			0.95		0.90		0.61	
Efron's pseudo R <sup>2</sup>	22.5%		24.5%		25.4%		26.0%	
Ratio of correct classifications	71.96%		73.59%		73.21%		73.40%	
Wald test <sup>a</sup>			20.16***		26.71***		39.83***	
(degrees of freedom)			(2)		(3)		(5)	

Note:

Coefficients report firm-level clustered standard errors in parentheses

Marginal effects report robust standard errors in parentheses

†  $p < 0.10$ , \*  $p < 0.05$ , \*\*  $p < 0.01$ , \*\*\*  $p < 0.001$

<sup>a</sup> Reference model is (1).

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**PAPER C. GOVERNANCE HETEROGENEITY IN FAMILY FIRMS AND THE  
ESTABLISHMENT MODE: THE ROLE OF EXTERNAL DIRECTORS AND  
FOUNDERS**

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**ABSTRACT**

This paper examines how governance heterogeneity among family firms influences internationalization decisions, such as the establishment mode choice. Relying on agency theory and stewardship theory, we argue that non-family board directors balance the families' preferences for greenfield investments, by enlarging the set of valuable strategic alternatives, and thus promoting more foreign acquisitions. However, if the family firm's founder has been appointed as the board president, her/him authority and charisma limit the influence of external directors, hence enforcing the family's dominant logic. We test our hypotheses on a sample of 1,943 foreign initiatives undertaken by 556 Italian family firms. After taking into account that the board composition may be endogenous to the establishment mode choice, we find empirical support for them.



## **Introduction**

A growing body of literature has investigated the way in which family firms (FFs) internationalize. The reason is twofold. On the one hand, a globalized economy requires every firm –also those that traditionally have been eager to operate only domestically– to think and operate globally, as it is often crucial for their profitability and survival. On the other hand, FFs significantly differ from their non-family counterparts and provide an interesting test bed for confirming and/or extending the theories of internationalization.

However, although acknowledging differences in several dimensions of the internationalization process (e.g. the time of internationalization, the export intensity and extensity, and the entry mode chosen, see among the others Arregle *et al.*, 2012; Fernandez and Nieto, 2006; Holt, 2012; Pukall and Calabrò, 2014), theoretical and empirical findings about the FFs' strategies in foreign markets have been often mixed and inconclusive (e.g. Fernandez and Nieto, 2006; Zahra, 2003). We posit that one possible explanation is that the literature has generally grouped under the FF label different business organizations that share the presence of a family as a blockholder, but adopt various governance systems. Indeed, heterogeneity within FFs has been shown to explain conundrums in other strategic decisions –such as investment policy (Anderson, Duru and Reeb, 2012), and financial leverage (Schulze, Lubatkin and Dino, 2003) – and also their effect on firm performances (Anderson and Reeb, 2004; Miller, Minichilli and Corbetta, 2013).

The purpose of this paper is to build on these two pillars and investigate how FFs' heterogeneity influences a fundamental aspect of internationalization, that is the choice between acquiring an existing firm in the host market –i.e., acquisition– and establishing a new venture from scratch abroad –i.e., greenfield investment. Such a choice is reported in the literature as the establishment mode choice (Slangen and Hennart, 2007). The issue is

quite popular in internationalization studies, although the governance dimension has been generally overlooked (Strange *et al.*, 2009). First, both greenfield initiatives and acquisitions require significant foreign direct investments (FDIs), thus being risky and high-commitment operations that involve the approval of the apical governance bodies of FFs. Moreover, the establishment mode choice compares two ways of international growth that are diametrical: an internal and possibly systematic growth –i.e., the greenfield investment– and an external, often discontinuous and shocking one –i.e., the acquisition. Furthermore, a wrong entry decision can threaten the firm’s long-term flourishing, and lead to important wealth losses (Slangen and Hennart, 2008).

The outcome of such decision-making depends on how the preferences and goals of the different actors that govern the FF reach an equilibrium. Indeed, FFs in modern economies are not exclusively family-centric, as many other actors –minority shareholders (especially financial and institutional investors), non-family members in the board of directors, external top managers– are actively involved in the definition of the firm’s strategy. This variety of actors implies diversified attitudes and interests, as well as a richer endowment of information and knowledge that influences their evaluation of alternatives. Thus, coalitions, but also misalignments and conflicts between parties may arise, the settlement of which depends on the corporate governance and its mechanisms.

In this context, we first illustrate the strategic lens through which different actors in FFs view the business environment (Von Krogh, Erat and Macus, 2000) and, consequently, the firm’s establishment mode choice in foreign markets. In fact, actors differ with reference to their risk attitude, perceptions on how the FF may capitalize on its competitive advantages, and access to information and knowledge about foreign markets.

Subsequently, we study the role of governance mechanisms in the decision process,

starting from the assumption that in FFs the board of directors have the pivotal role in taking all the relevant strategic decisions. Specifically, we investigate the heterogeneity in the FF's board in terms of the presence of non-family directors and the family firm's founder, and the relationship with the firm's establishment mode choice. In so doing, we integrate the traditional International Business (IB) framework with contributes stemming from the agency theory and the stewardship theory (Chrisman *et al.*, 2007; Corbetta and Salvato, 2004; Le-Breton Miller and Miller, 2009; Miller and Le Breton-Miller, 2006).

Namely, we argue that the power exerted by the families drives the firm to prefer greenfield investments rather than acquisitions. However, the presence of non-family directors in the board enlarges the set of valuable strategic alternatives thus promoting foreign acquisitions, unless the family firm's founder sits on the board of directors whence s/he exerts authority and charisma that still dominates FFs' choices.

We test our relevant hypotheses through econometric models, which control for the endogeneity between board composition and strategic choices in family firms. We run the analyses on a sample of 1,943 manufacturing investments undertaken abroad by 556 Italian FFs between 2000 and 2013.

Our study adds to the literature in several ways. We cross-fertilize IB literature with the family business debate on FFs' decision-making peculiarities by developing a fine-grained analysis of the relationship between FFs' heterogeneity related to governance structures and their strategies in foreign contexts (Strange *et al.*, 2009). Thus, we enlarge our understanding of FFs' international strategies. In addition, our study contributes to the growing debate on what triggers strategic exploration in FFs (De Massis *et al.*, 2014; Eddleston, Kellermanns and Sarathy, 2008), and how the specific attitudes and preferences

of controlling families can be mitigated by the presence of minority shareholders and external directors in the board.

The remainder of the paper is structured as follows. Section 2 reviews the relevant literature and develops our hypotheses. Section 3 reports the data, the variables, and the econometric models adopted, while section 4 presents the findings of the econometric analyses. Section 5 concludes and illustrates some possible avenues for further research.

## **Theoretical Background and Hypotheses**

### **The establishment mode choice in foreign markets**

International business literature has broadly studied the trade-off between greenfield investments and acquisitions abroad (see Slangen and Hennart, 2007 for a comprehensive review). Despite the two strategies are both subject to the uncertainty due to liability of foreignness (Zaheer, 1995), they differ in terms of benefits and risks. On the one hand, greenfield investments allow the replication of the domestic routines, by choosing the organization's view, workforce, strategy, and the like from the outset. In particular, the transaction costs involved in the transfer of firm-specific knowledge and assets, and the financial and business risks of being in touch with third parties (as in acquisitions) are reduced (Hennart and Park, 1993). However, greenfield investments have some disadvantages. First, it cannot be possible to directly access country-specific complementary assets needed to enter effectively the foreign market and that can be acquired hardly via arm's length transactions. Second, as Vermeulen and Barkema (2001) argue, the pure exploitation strategy reduces the firm's ability to create new knowledge, and leads to a process of ossification –i.e., organizational inertia–and simplicity, with the

subsidiaries often utilizing the same technological set, competitive actions, and organizational structure of the parent firm. Finally, because of relying on the domestic business model, local needs may be overlooked, especially in foreign contexts considerably different from the domestic one.

On the other hand, acquisitions are a quicker way to access privileged information and knowledge embedded in the acquired foreign firm and its relevant business network, and allow incorporating other firm- and country-specific complementary resources –both tangible and intangible– that may be combined with the parent ones in order to build and sustain the firm’s competitive advantage. However, also acquisitions brings its own set of risks. Organizational culture and procedures of the acquirer and of the acquired firm cannot fit each other, so making difficult the transfer and integration of competitive advantage. In particular, acquisitions are exposed to adverse selection and moral hazard relevant to the seller-acquirer relationship, which are amplified by the information barrier of operating in a foreign country. Further, acquisitions often require a large front-end payment and can excessively increase the firm’s exposition over time, which may cause financial deterioration and increase the probability of bankruptcy (Furfine and Rosen, 2011).

Firms investing abroad have to weigh up *pros* and *cons* of the two establishment modes and solve the related dilemma under condition of bounded rationality. In this context, as Porter (1990: 110) pointed out, “the firms’ goals and decision-making are most strongly determinate by ownership structure, the motivation of owners, and the nature of corporate governance.” This is especially true in FFs, where families, as the main shareholders, shape the firm’s strategy in order to fulfill their attitude and preferences.

### **Different actors and goals in family firms**

Although families take the center stage, FFs are complex organizations that cannot be limited to the family dimension. Different actors with different attitudes and preferences contribute to evaluate alternatives and choose the establishment mode. The output of decision-making process depends on the relative power and the features of the actors, the interactions between them, and the way in which they align their interests in the apical governance bodies of the firm. From this perspective, FFs exhibit a high heterogeneity that deserves to be deeply investigated.

Concerning families, their strategic behaviour has been vastly acknowledged in family business literature. First, as families often freeze a large proportion of their economic and emotional wealth into the firm (Berrone *et al.*, 2012), they act to preserve the business, thus becoming significantly risk averse, and refraining from actions that can undermine continuity and trans-generational control of the firm (Faccio, Marchica and Mura, 2011). This risk aversion translates into the aversion to dilute the family control on the firm, thus avoiding business operations that can imply selling part of their stakes to outsiders (Caprio, Croci and Del Giudice, 2011).

The implications of this line of reasoning suggest that families prefer internal rather than external growth, especially in unfamiliar context, as in foreign markets. International acquisitions are more risky and the funding of a cash takeover increases the probability of the sale of future unwelcomed new equity, so diluting the voting power of the family's stake (Martynova and Renneboog, 2009). As an alternative, greenfield investments are more cautious and flexible in nature (Brouthers and Dikova, 2010), thus allowing to self-finance international operations.

Second, families are aware that their firms' build upon competitive advantages that

are idiosyncratic and tacit in nature, since they originate from the overlap between the family and the firm (Carney, 2005). According to stewardship theory, FFs have unique organizational structure and procedures that are the evolutionary results of the continuous interaction among family members and other stakeholders (Habbershon, Williams and MacMillan, 2003). These specific assets and practices are hardly replicable outside the family (Gedajlovic and Carney, 2010; Le Breton-Miller and Miller, 2006), and greenfield investments again constitute the more suitable way to transfer abroad the assets (Slangen and Hennart, 2007). Indeed, by establishing a venture from scratch, the risk of disrupting or dissipating relevant core competencies is minimized, and so are the parent-subsidiary coordination and integration problems that can make ineffective the firm's procedures and routines, as it happens in acquisitions (Calipha, Tarba and Brock, 2010).

Finally, families often lack the international experience to reinforce the FF's antidotes to uncertainty and reduce their liability of foreignness. As studies in IB have shown, learning-through experience increase the ability of firms to deal with foreign countries, i.e., to interface with local formal and informal institutions, workforce, and the like (e.g. Dow and Larimo, 2009). Such an experience can mitigate the perceived risk about different forms of international expansion and consequently improve the effectiveness in evaluating the trade-off between greenfields and acquisitions. However, in that respect, FFs can bear some family-specific agency problems. Because of altruistic behavior –which gives rise to nepotism–, apical positions in FFs are often restricted to family members (Schulze *et al.*, 2003; La Porta *et al.*, 2000), so that firms are out of the competition for more talented, well-informed, and more internationally experienced external managers. As family members often spend their whole career within the firm, their learning about foreign markets are just limited to the in-house experience. With reference to the establishment

mode choice, this shortage of competences implies that controlling families are less able to understand and manage the real risks of international operations, so reinforcing their preference for greenfield initiatives.

Building upon these three pillars, we claim that families tend to mold the firms with their *dominant logic* (Prahalad and Bettis, 1986) that constrains the exploration of alternatives and the processing of information in decision-making, thus tipping the scales in favour of greenfield investments as preferred establishment mode.

Among the other actors, agency arguments suggest that managers are the prime suspects to pursue their own interests and extract private benefit at the expense of the shareholders. Self-interest and hubris push them to act for maximizing firm's growth and empire building, regardless of any implication for the firm's value and its long term survival. At least in the short and medium term, international diversification and acquisitions are a suitable way to pursue these goals. Thus, managers' attitude turn out to be in conflict with the more conservative orientation of families towards a gradual expansion pursued by means of greenfield initiatives.

However, agency theory acknowledges that FFs are less affected by agency costs related to the shareholder-manager misalignment problem than publicly widely held firms are (Jensen and Meckling, 1976). Given their economic and emotional concern about firm's wealth, owning families have strong economic incentives to monitor and discipline internal decision makers, exercising their influence through formal (e.g. board of directors) and informal (e.g. *moral suasion*) instruments. As a result, FFs exhibit a superior ability to prevent detrimental takeovers by hubris-infected managers (Morck, Shleifer and Vishny, 1990). Furthermore, the alignment of interest is eased by the very frequent presence of family members with apical roles in the management team.

Conversely, FFs may suffer from principal-principal agency costs. Minority shareholders, especially financial and institutional investors, are not emotionally involved in the firm and aim at maximizing the return of their investments. They are less risk-averse, since their investment in the FF is just one of the multiple stakes they own in several companies (Schmid *et al.*, 2014), and the relevant idiosyncratic risk is diversifiable at the portfolio level. Additionally, financial and institutional shareholders act based on information, know-how, and professional competencies, resulting from their learning-through-experience in other firms, sectors, and markets. Thus, their set of perceived strategic alternatives of entry mode in international markets is larger than the family's one and not *a priori* against more risky acquisitions. Overall, such peculiarities could result in a divergence of interests and goals between minority shareholders and the family.

In principle, several corporate governance mechanisms may attenuate conflicts between controlling and minority shareholders, e.g. market for corporate control, compensation incentives, and the board of directors. However, some mechanisms are ineffective due to the FF's features. The market for corporate control often does not work, as it is not possible to take over the family's stake, who keeps its blockholdings. Compensation incentives are normally used to encourage managers to maximize firm value, thus reducing the risk of shareholders' expropriation, but where large family blockholders are present, they can bypass this governance system by exerting a direct control and influence on management. Conversely, the board of directors can have an important role in fostering firm performances also in family firms (Westphal, 1998). In these firms, the role of the board as the controller of the managers' actions becomes depleted, while it plays a central role in mitigating the conflicts among shareholders (Anderson and Reeb, 2004). With regard to the object of this study, the board of directors is the apical body in charge of

shaping the firm's internationalization strategy and approving the major investments. Its composition is heterogeneous and it is critical to understand the decision process. We analyze board heterogeneity –and its impact on the establishment mode choice– under two dimensions: the role of non-family directors and the founder in the board.

### **The role of the board of directors**

In an agency theory perspective, minority shareholders find in the appointment of non-family directors an effective way to safeguard their rights in the face of the controlling owners' manipulations (Renders and Gaeremynck, 2012). Likewise, controlling families appoint their relatives as board members to protect their interest and possibly extract wealth from the minority shareholders. As regard as our dimension of analysis –the establishment mode choice– one can expect that family board members push towards the implementation of greenfield investments to better satisfy the family's preferences, while non-family members would support a strategy in international markets that extends the set of choice, exploring the opportunities for more risky, but also potentially more innovative and value-creating foreign acquisitions.

However, both family owners and minority shareholders are interested to establish good governance mechanisms. In particular, from the family's point of view, the openness of the board to non-family members makes the firm more attractive to external investors, thus overcoming the lack of financial resources that can hinder the firm from seizing business opportunities (Paeglis and Tirtiroglu, 2007). Furthermore, by appointing non-family directors, in addition to those nominated by minority shareholders, controlling family can rely on a plausibly fair and effective governance system able to solve or mitigate principal-principal agency conflicts (Anderson and Reeb, 2004). Finally, facing an

increasing market uncertainty and business complexity, family owners can be aware that their firm lacks a global mind-set and the relevant information and knowledge. Under this condition, acting as stewards, family owners may appoint non-family directors in order to expand the firm's competences, thus empowering the role of the board as a strategy advisor (Corbetta and Salvato, 2004; Miller and Le Breton Miller, 2006).

The FF literature emphasizes the role of the board of directors as resource-provider (Bammens, Voordeckers and Van Gils, 2011). In fact, external directors are not as emotionally tied to the FF as family directors and, they have matured experiences in other companies or institutions. Thus, they bring to the FF competences and advises that broaden the strategy boundaries and make more effective the decision-making, also taking into account the multiple set of shareholders preferences. This is particularly true when uncertainty is severe, as in the case of entry mode in foreign market. In this light, we expect that the presence of non-family directors counterbalances the high propensity of the owning family towards greenfield investments. For instance, non-family directors may prevent the ossification and organizational inertia that follow a greenfield-based strategy, making shareholders aware of the risks that it involves for the firm (even if it can be beneficial for family owners). Further, they may be able to reduce the common owning family's perception of risks in acquisitions, and advise about the upside of acquisitions when the FF requires complementary assets that cannot be easily developed internally. Lastly, non-family members may possess more managerial competences and valuable information about foreign business and context so to reduce *ex-ante* and *ex-post* acquisition costs (Graves and Thomas, 2008).

As a result, we expect that non-family members within the board would enlarge the set of strategic options available and do not replicate ritualistically greenfield investments,

while better evaluating real benefits and risks of foreign acquisitions. To sum up, according to both agency and stewardship theory, we state the following hypothesis:

*H1. The share of non-family board members negatively influences the likelihood to enter a foreign country through a greenfield investment, other things being equal.*

### **The role of the founder**

Family firms' founders may be actively involved in the firm's governance or not, i.e., whether they are appointed in the board of directors. We focus on the founder who serves as the FF's president and discuss how this role influences the firm's establishment mode choice.

According to the stewardship theory, the founder shows in general a strong emotional connection to the FF (Villalonga and Amit, 2010) as s/he contributed to the creation, development, and success of the firm. The firm's culture is indissolubly linked to the founder's view as "s/he makes the initial decisions regarding the firm's mission, goals, strategies, and structure as well as the day-to-day operating decisions that influence the firm as it grows and evolves" (Eddleston, 2008: 1056) and s/he has personally contributed to develop the firm's family-idiosyncratic routines and procedures (Bertrand and Schoar, 2006). Acting as guardian angel of the firm and its culture, s/he is adverse to risk and dilution of control more than other family members and perceives the firm's assets as extremely hard to embed in other organization. Thus, we claim that, when expanding abroad, founders reinforce the family dominant logic and push the board to replicate the business model they already successfully experimented, so opting for greenfield investments. Therefore, we state as follows:

*H2a. The presence of the founder who serves as the president of the board of directors*

*positively influences the likelihood to enter a foreign country through a greenfield investment, other things being equal.*

Furthermore, the unique set of experiences accumulated by the founder and the business and institutional network s/he has developed during the career increase her/his charisma. This way, other people within the organization recognize her/him as a steward who drives the business and brings valuable skills to the firm that foster its value (Kelly, Athanassiou and Crittenden, 2000; Nelson, 2003).

Integrating agency and stewardship arguments, Villalonga and Amit (2006) adduce that the founder's authority and charisma mitigate the principal-principal conflicts and help the alignment between the external members of the board and the controlling family. Indeed, non-family members of the board recognize that the founder leadership relies on genuine expertise and capability that are of vital importance for the firm, differently from the case in which family heirs govern the firm. Thus, they look at her/him as the pivot for any strategic decision and are more prone to complain with her/him when some dispute arises (Kelly *et al.*, 2000). Accordingly, we expect that the role of non-family board members in the decreasing attitude towards greenfield investments is moderated by the presence of the founder acting as the president of the board of directors. Specifically, our last hypothesis states as follows:

*H2b. The presence of the founder within the board of directors positively moderates the negative relationship between the share of non-family directors and the likelihood to enter a foreign country through a greenfield investment, other things being equal.*

## **Methodology**

### **Sample description**

Although the debate in the literature is broad, most scholars agree that FFs are those firms whose family owners exert decisive influence over key governance choices and the strategic direction of the firm (Minichilli *et al.*, 2014). The family control has been traditionally defined through a threshold in the equity percentage; however, due to the high variety of the countries investigated, and the relevant markets for corporate control (Gomez-Mejia *et al.*, 2011), the equity threshold considered has varied from 1% to 50% (Anderson and Reeb, 2004; Miller *et al.*, 2013). Indeed, markets characterized by fragmented ownership (e.g. the Anglo-Saxon countries) allow control even through a small equity stake, given the high dispersion of minority shareholders. Conversely, in markets (e.g. many European countries) where ownership is highly concentrated control requires a higher equity threshold (La Porta *et al.*, 2000). Accordingly, to identify Italian FFs, we select those companies that are controlled by one or two families with a 50% (if unlisted) or 25% stake (if listed), or by an entity to which the same conditions above apply (Miller *et al.*, 2013). Data come from the Observatory AUB of Italian Family Businesses developed at Bocconi University.

To identify the data about the foreign entries performed by the FFs, we rely on Reprint, a database developed at Politecnico di Milano, which lists information about the initiatives undertaken by Italian firms worldwide (for further details, see Mariotti, Mutinelli and Sansoucy, 2015). We obtain 1,943 entries undertaken in 63 different countries by 556 Italian FFs between 2000 and 2013. With regard to the geographic distribution, the most frequent host country is the United States, followed by Germany, China, France, and the

United Kingdom (not tabulated). However, none of the host countries presents a frequency distribution higher than 10%, so we can assume that the sample is evenly distributed at the geographical level.

### **Dependent variable**

The aim of our study is to investigate how FFs' board composition affects the establishment mode choice in foreign markets. Coherently with previous literature (Brouthers and Brouthers, 2000; Hennart and Park, 1993), the dependent variable *Establishment mode* is a dummy taking value 1 if the foreign entry is a greenfield, and 0 if it is an acquisition.

### **Explanatory variables**

With regard to the presence of external directors in the board, we calculate the variable *Non-family board ratio* as the share of non-family members appointed in the board of directors over the total number of directors. The 97.14% of the foreign entries in our database are performed by firms with a one-tier board system; the remaining 2.86% of the observations are run by firms with a two-tier board system<sup>23</sup>. The variable ranges from 0 (no external members) to 1 (each member is external to the controlling family). We operationalize the variable *Founder* as a dichotomous variable taking value 1 when the president of the board of directors is also the founder of the family firms and 0 otherwise.

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<sup>23</sup> In the latter case, we focus on the management board composition, since our research questions concern FFs' strategies, rather than the supervisory board.

## **Controls**

As previous studies have already identified several predictors that affect the entry mode (Slangen and Hennart, 2007), we insert them as control variables in our model in order to avoid any bias due to the omitted variables issue. At the country-level, the cultural distance between the home country (i.e., Italy) and the host country plays a central role. Indeed, the higher the cultural distance between the two countries the higher the uncertainty perceived by the parent firm (Brouthers and Brouthers, 2000). To partially solve the issue related to the cultural distance, firms opt for greenfield investments, since they allow choosing from the outset the workforce, the business organization, and such (Larimo, 2003). We operationalize *Cultural distance* with the five Hofstede (2001) cultural dimensions (power distance index, individualism, uncertainty avoidance index, masculinity, and long-term orientation) in a single index, following the Kogut and Singh (1988) formula:

$$Cultural\ distance = \frac{1}{5} \sqrt{\sum_{i=1}^5 \frac{(I_{ij} - I_{ik})^2}{Var(i)}}$$

where:

$I_{ij}$  is the factor of the  $i$ -th dimension for the  $j$ -th country (i.e., Italy);

$I_{ik}$  is the factor of the  $i$ -th dimension for the  $k$ -th country (i.e., the host country);

$Var(i)$  is the variance of the factors for the  $i$ -th dimension.

In addition, *Geographic distance* contributes to increase the firms' perceived uncertainty and the agency and transaction costs relevant to acquisitions (Malhotra and Gaur, 2013). We collect air distance data between Italy and the foreign country's capital cities from the CEPII database on geographic distance. Data are then log-transformed because of the right skewness of the distribution.

Other variables relevant at the investment-level are the *Economic freedom* and the *Gross Domestic Product (GDP) growth* of the host country. Freer countries allow foreigners to do business without raising barriers, especially in acquisitions (Vermeulen and Barkema, 2001). Therefore, the lower the degree of economic freedom the higher the likelihood of entering the country through a greenfield investment. Data come from the Heritage Foundation and the Wall Street Journal and range between 0 (less free countries) to 100 (most free countries). We divided it by 100 to rescale it, thus in our analyses *Economic freedom* varies from 0 to 1. Additionally, the *GDP growth* of the host market indicates whether the aggregate demand is expanding. When this is the case, there is the opportunity to increase the aggregate supply (therefore establishing a new venture that produces additional goods). On the other hand, when the market is saturated, acquisition is preferred because no new production is installed. We collect data from the World Bank database on GDP. Finally, we insert a set of dummy variables controlling for the year fixed effect (*Year dummies*), which may affect the entry mode choice and are not captured by the other regressors.

Moving to the firm level, we consider other variables, such as the firm's international experience, age, size and the sector where it is active. *International experience* accounts for previous entries that the parent firm has undertaken internationally. We create a dummy variable (*International experience*) taking value 1 when the parent firm has already undertaken previous foreign entries and 0 otherwise. In the international business literature, findings about the impact of international experience on the entry mode are mixed. Accordingly, we do not state any prediction about the role of international experience on the entry mode. On the one hand, some authors argue that more internationally experienced firms possess a competitive advantage in exploiting their

routines and organizational procedures in international contexts, thus finding more advantageous to transfer them through greenfield investments (Brouthers and Brouthers, 2000; Cho and Padmanabhan, 1995). On the other hand, other scholars posit that firms with international experience have a direct knowledge of the international market for corporate control. Consequently, they face lower costs associated with target selection and post-integration process in acquisition, thus performing less greenfield investments (Larimo, 2003). *Parent age* and *Parent size* control for firm-specific aspects that might affect the entry mode choice. In particular, older and larger firms possess a wider range of internal resources and, thus, have a weaker incentive to acquire complementary resources in international markets (Meyer and Estrin, 2001). We operationalize the former as the difference between the foreign entry's year and the FF's foundation year. Data are log-transformed because of the right skewness of the distribution. The latter is computed as the aggregate parent firm's sales. The data are retrieved from the AIDA – Bureau van Dijk database. Then, we consider the dummy variable *Manufacturing* equal to 1 if the main sector in which the firm is active is included between 10 and 33 of the 2-digit NACE classification; it is 0 if the NACE code is included between 34 and 63. Firms active in the financial, public and defence sectors are excluded from the analyses because of their peculiarities that make them hardly comparable to the other industries.

Finally, we control for some directors and president's individual characteristics, as they may influence firm's behaviour (Bertrand and Schoar, 2006). We include such variables to avoid any potential bias due to their omission but we do not have any a priori expectation on their impact on the entry mode choice. First, we consider whether the CEO is a non-family member. We expect that outside CEO will be less committed to the family's strategies and more willing to adopt empire-building actions, thus, pushing to engage in

international acquisitions. *Non-family CEO* takes value 1 if CEO does not belong to the owning family and it is 0 otherwise. Moreover, we consider the *Board members' mean age*, which is the average age of the board members sitting on the board at the investment's year. We also insert the *President tenure*, which is the years that s/he has been serving the firm in the reference year. Finally, we consider for gender issue by controlling for *President woman* that is equal to 1 when the president is a female and 0 when he is a male and for the *Chief Executive Officer (CEO) duality* variable, which takes value 1 if the CEO serves also as the president, and 0 otherwise.

## **Model**

Board composition is not exogenous with reference to the expansion in foreign markets. Indeed, both board composition and the establishment mode choice are affected by latent variables, such as the owning family's preferences about the strategy abroad, its power among other shareholders, and such. For instance, family principals may decide to appoint talented external directors in order to pursue an acquisition-driven international growth. To take account of such a potential endogeneity, we structure a two-stage model. In the first stage, we regress the percentage of non-family board members (over the total) on some regressors that take account of the shareholders composition and the family power. In the second stage, we employ the predicted values of board compositions from the first stage as a regressor of the establishment mode choice and we will test, thus, the hypotheses.

Formally, the first stage may be stated as:

$$z = \delta + \theta W + \omega$$

Where  $z$  is the actual percentage of non-family board members;  $\delta$  is the constant of the model;  $\theta$  is the estimated coefficients' vector;  $W$  is the set of regressors that explains the

percentage of non-family board members;  $\omega$  is the error term. The predicted value of  $z$  will then be employed in the second stage, which takes the form of:

$$\Pr(y = 1|\hat{z}, X) = \Phi(\alpha + \beta\hat{z} + \gamma X + \varepsilon)$$

Where  $\Pr(y = 1|\hat{z}, X)$  is the probability that the dependent variable Establishment mode takes the value 1 (i.e., it is a greenfield investment), conditional to the full set of regressors;  $\Phi$  is the cumulative distribution function of the standard normal distribution;  $\alpha$  is the constant of the model;  $\beta$  is the coefficient of the predicted value of non-family board ratio ( $\hat{z}$ );  $\gamma$  is the estimated coefficients' vector of the other independent variables in the model;  $\varepsilon$  is the error term.

The first stage of the model is specified through OLS estimation. Indeed, despite the non-family board ratio is censored between 0 (no external board member) and 1 (no family board member), thus suggesting the employment of a two-side censored Tobit model, it would have the disadvantage of inflating standard errors. It is common in empirical studies to model the first stage under linear assumptions in order to avoid such an issue, even if the real data-generating process is non-linear. We identify a few predictors that influence the non-family board ratio and that should be weakly correlated with the establishment mode choice (see the Results section for detailed tests of endogeneity). To start with, we take into account of the equity stake held by the owning family (*Family ownership*). We expect that the higher such a stake the less it is likely that non-family directors will be appointed, as the family prefers to nominate family members instead. Additionally, we investigate whether non-family shareholders are institutional investors. We expect that these investors are particularly worried about the risk that family members pursue private benefit at their expense, thus asking for board representation. Therefore, we include the *Private equity* dummy variable taking value 1 when a private equity is a shareholder of the FF and 0

otherwise. Further, the more the ownership is concentrated the more non-family members will be appointed. Indeed, the family already has a strong influence on the firm and, thus, nominates outside members that may bring external resources to the firm. We capture this effect with the *Herfindahl index*<sup>24</sup> of the equity concentration. Board composition may be also affected by the family generation running the firm. We expect that first generation is more involved in the FF activities and, thus, family members ask to be present in the board. Later generation, instead, are more likely to behave as investors that are more detached. Therefore, we include the dummy variable *First generation*, that is 1 when the family members belong to the first generation and 0 otherwise, and we expect a negative sign on the appointment of non-family board members. Finally, we consider whether there is a change in the firm leadership (*Leadership change*), meaning that the CEO or the executive president have changed in the last year. We suppose that a change in the apical role in the firm may be followed by a wider restructure of the FF's apical bodies, such as the board of directors.

With regard to the second stage, we specify the econometric model according to the nature of the dependent variable. Since the establishment mode has a dichotomous distribution, we opt for the probit model, which limits the predictions between 0 and 1, and assumes that the errors are normally distributed. Furthermore, in our data set we have FFs that are responsible for multiple foreign entries. Since investments undertaken by the same firm are likely related, we cluster the standard errors at the firm level. Finally, in order to test H2b, we have to investigate the interacted term between (predicted) non-family board ratio and the presence of the founder-president in the board. In linear models, the

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<sup>24</sup>*Herfindahl index* =  $\sum_{i=0}^n s_i^2$ , where  $s_i$  is the ratio of equity held by the  $i$ -th shareholder.

interpretation of such effect is simply the first derivative of the regression's coefficients. In nonlinear models, such as the probit model, the interpretation is less straightforward because the linearity assumption is violated and, thus, the first derivative depends on the full set of regressors (Ai and Norton, 2003). As a result, the coefficient of the interacted term may be not representative of the true statistical effect. The issue can be solved by performing graphical analysis (Hoetker, 2007), as we report in the results section.

## **Results**

Table 1 reports some descriptive statistics of the variables employed in the first stage of the regression analyses. To start with, we observe that non-family board members are on average the 53 percent of the total, while the average family stake in the FF equity is 79.7 percent, thus confirming the high concentration of the Italian equity market. Further, 2.8 percent of the firms in the database have a private equity among their shareholders, equity holdings are relatively concentrated, with an Herfindahl index of 0.495 and, finally, 28.9 percent of the firms are run by the first family generation.

The three main characteristics that an instrument (or set of instruments) should possess are: it is correlated with the endogenous variable; it is not correlated with the second stage dependent variable; it is not present among the regressors of the second stage. While the third requirement is obviously met, we test empirically the consistency of the others. The fourth and fifth columns in Table 1 show the pairwise correlation of the first stage regressors with the second (Establishment mode) and first stage (Non-family board ratio) dependent variables, respectively. We note that none of the selected regressors is correlated with Establishment mode at the 5 percent significance level, while all of them

are significantly correlated with Non-family board ratio. After this first check, we sustain that variables chosen in the first stage are good instruments of the endogenous variable Non-family board. Before estimating the first stage coefficients and calculating the predicted values, we observe that the regressors do not suffer of multicollinearity as the single variance inflation factors (VIF) are never higher than 10 – the widely accepted threshold to detect collinearity – while the mean VIF is 1.267, well below the standard threshold of 6 (Hair *et al.*, 2010).

*[insert Table 1 about here]*

Table 2 lists the first stage estimated coefficients of the selected regressors on Non-family board ratio. In addition to the OLS estimates, which will employed to calculate the predicted values of Non-family board ratio in the second stage, we also report the Tobit estimates only to show that coefficients do not substantially vary also using a model that best fits the real data generating process. Regardless of the distribution chosen, it emerges that each of the selected regressors is highly significant and with the expected sign, with the exception of Leadership change that, although positive as expected, does not load to significance.

*[insert Table 2 about here]*

Table 3 examines the descriptive statistics and correlation matrix of the variables employed in the second stage. On average, 79.1 percent of the foreign entries considered are greenfield investments. The average predicted value of non-family board ratio is 53.1 percent, while the founder serves as the FF's president in the 35.1 percent of the cases. No concern emerges about the value of the correlations. The highest value is 0.416, the correlation between Parent age and size, which seems reasonable, as older firms are often the larger ones. However, we compute the VIF and thresholds are never violated neither as

single factors (the highest is 1.954) nor as a mean that is equal to 1.370.

*[insert Table 3 about here]*

As a preliminary check of our hypotheses, we calculate the mean of each regressor conditionally on whether the foreign entry is a greenfield or an acquisition. We also test the conservative two-tailed test on the means' differences and report the results in Table 4. We observe that the share of non-family members sitting on the board is lower for firms undertaking a greenfield investment (52.9%) than for those that acquire a foreign firm (55.1%). Such a difference is significant at the 1 percent level, thus providing a rough corroboration of H1. Moreover, 37.1 percent of family firms with the founder serving also as president undertook a greenfield investment abroad, while only 27.5 percent chose an acquisition. Since the difference is significant at the 0.1 percent level, we have a signal that H2a should be supported as well. Finally, we calculate that when the founder is the FFs' president, there is no significant difference between the non-family board ratio of FFs opting for greenfield (45.2%) and those going for acquisition (43.1%). On the other hand, when the founder is not the president, such a difference exists and it is significant at the 5 percent level, since the non-family board ratio is equal to 56.9 percent for those adopting a greenfield investment and 59.7 percent for those acquiring a foreign firm. These evidences suggest that H2b should be corroborated too.

*[insert Table 4 about here]*

In Table 5, we report the results of the regression models where the dependent variable is Establishment mode, while in Table 6 we have the corresponding average marginal effects. In model (1) of Table 5 and 6, we consider only control variables. As expected, cultural distance has a positive effect on the likelihood of establishing a foreign greenfield, and it is significant at the 5 percent level. Moreover, the likelihood of a venture

from scratch is higher in countries characterized by high GDP growth (significant at the 1% level). Moving to the firm-level controls, we observe that firms with previous international experience are more likely to opt for greenfield investments (the estimated coefficient of international experience is significant at the 1% level). In particular, we see from Table 6 that experienced firms show 12.6 percent higher probability to make greenfield investments than non-experienced ones. This result supports the argument that internationally experienced firms find more advantageous to transfer abroad idiosyncratic assets through greenfield investments (Brouthers and Brouthers, 2000; Cho and Padmanabhan, 1995).

In model (2), we also add the variable Non-family board ratio and, thus, test H1. The coefficient of this variable is equal to -0.994 and it is significant at the 0.1 percent level. In probability terms, when the ratio of non-family members increases by 10 percent, the probability that the family firms goes for a greenfield decreases by 2.36 percent. We test whether Non-family board ratio is actually endogenous through both the Durbin and Wu-Hausman tests. Both tests reject the null hypothesis that this variable is exogenous with p-values of 0.018 and 0.019, respectively. Further, both the Sargan and Basman test of overidentifying restrictions do not reject the null hypothesis that the instruments are both valid (uncorrelated with the error term) and correctly excluded from the second stage equation. H2 is then corroborated.

In model (3), the variable Founder shows a positive and significant (at the 1% level) effect on the probability of choosing a greenfield investment. Again, we compute the average marginal effect and we report a 6.2 percent increase in probability when the founder is the president compared to family firms without the founder serving as the president. H2a is thus supported by the data.

Finally, in model (4), we test the interaction between Non-family board ratio and

Founder. The two direct effects are still significant and with the expected sign. The interacted term is positive and significant at the 0.1 percent level. However, as discussed above, the coefficient of the interaction may not represent the true statistical effect and a graphical analysis is required. Thus, in Figure 1, we show the average marginal effects of Non-family board ratio on the probability of choosing a greenfield when the founder acts as the president (solid line) or not (dashed line). It is evident that the non-family members' power to shift the family firm's strategies towards international acquisitions is negligible when the founder is present. On the other hand, when the founder is not the president, the probability of making acquisitions increases linearly as the share of non-family board members increases. Then, H2b is fully supported.

*[insert Figure 1 about here]*

## **Discussion and Conclusions**

We find full empirical support of the relationship between board composition in family firms and their establishment mode choice in foreign markets. We show that non-family board members are more prone to invest abroad through acquisitions, which may expand the strategic set of options for the family firms. On the other hand, family directors are more stick to follow gradual and incremental international expansion through greenfield investments that preserve the stock of financial and emotional wealth that the family has invested into the firm. This result is consistent when taking into account that the choice is endogenous with regard to the family's power into the firm. In fact, the family is the main shareholder and influence both the composition of board of directors and the firm's strategies. We test that such a relation is effectively endogenous and we instrument it

through a two-stage procedure.

Furthermore, the founder reinforces the family's preferences into the firm. Indeed, when s/he sits on the board, s/he pushes the firm's strategies towards the pursue of gradual international expansion –greenfield investments– also exercising her/his charisma over the non-family members. Indeed, the effect of non-family directors in a founder-governed board is negligible with regard to the establishment mode choice.

Our paper adds a piece to the puzzle regarding “the influence of family goals, governance, and resources on firm outcomes” (Chrisman *et al.*, 2013: 1249), with specific reference to the firm growth strategy in foreign markets. Furthermore, our results are in line with previous literature on the role of board of directors and family leaders. In particular, Arregle *et al.* (2012) highlight the relation between the family's interests and the appointment of non-family directors on the decision of exports intensity, where the presence of the former increases exports. Anderson and Reeb (2004) find that non-family board members foster firm's growth because they moderate principal-principal agency costs, both when they are appointed by the family and by minority shareholders. Nelson (2003) shows that active founders have a persistent influence on firms' strategies and governance and ownership arrangements even after an important change in firm's organizational life, i.e., after an initial public offering.

Our evidence on the interactions between board composition and strategies in FFs may be interpreted in the light of strategic management and organizational behavior theory. The more the power exerted by the family on the firm's governance, the more it dictates to minority shareholders and directors its dominant logic, which widely permeates the firm's organization. However, dominant logic imposes cognitive blinders which prevent the firm from seeing some relevant but peripheral information (Prahalad, 2004), thus determining a

specific form of bounded rationality (Simon, 1982) that limits the exploration of new opportunities. To remove these decision-making blinders, it is essential to enlarge the knowledge base for decisions, and to abandon successful recipes that are deeply embedded in the firm organization. We show that, in the context of FFs, the board of directors plays a fundamental role to both mitigate possible principal-principal conflicts and change/adjust the firm's strategic lens, in order to overcome the family's conservative bias and to expand the set of strategic alternatives.

Beyond the theoretical contribution, this work brings some practical implications too. Namely, family owners should be aware that opening their board to external members is beneficial for the FF's wealth, since their presence guarantees a better alignment of interest among shareholders, and lower agency costs lead to greater firm value (Anderson and Reeb, 2004; Villalonga and Amit, 2006). Moreover, their presence helps to see new opportunities and to be more innovative in capitalizing on family-specific competitive advantages, rather than relying solely on the transfer of internal knowledge. Furthermore, when the family leaders choose to establish a professionalized board, they should pursue this decision firmly and avoid depriving of authority the non-family board members, thus limiting or making ineffective their contributions to the FF.

As usual, this work is not exempt from limitations that, however, may pave the way to a rich future research agenda. It would be interesting to get more fine-grained aspects of the interactions among different shareholders and how they contribute to shape the board of directors. Despite we argue that the appointment of non-family directors has the same effect on the establishment mode both when nominated by the family and by minority shareholders, one might study whether this is the case empirically. Moreover, it would be important to understand how the founder acts in order to exert her/his leadership over the

other board members. Specifically, a more detailed analysis could reveal whether the founder induces the owning family to select *ex-ante* affiliated directors, who back her/his strategy, or s/he is able to exert her/his leadership also on more independent directors, regardless of their closeness to the owning family. Finally, our study is limited to Italian FFs. Although Italy is an ideal test bed for our analyses, because there are large and flourishing FFs, it would be useful to expand the study to other contexts and compare the results.

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## Tables and Figures

Table 1. Descriptive statistics of variables in the first stage (N = 1,943).

	Mean	S.D.	Establishment mode	Non-family board ratio	VIF
Non-family board ratio	0.530	0.298			
Family ownership	0.797	0.220	0.059	-0.592	1.648
Private equity	0.028	0.166	0.012	0.088	1.002
Herfindahl index	0.495	0.231	0.042	-0.241	1.622
First generation	0.289	0.453	0.048	-0.187	1.044
Leadership change	0.045	0.208	0.015	0.065	1.019

Note:

Correlation terms higher than |0.064| are significant at the two-tailed 5% statistical level

Correlation terms higher than |0.089| are significant at the two-tailed 1% statistical level

S.D. is standard deviation

Mean VIF is equal to 1.267

Table 2. OLS and Tobit regressions. Dependent variable: Non-family board ratio

	OLS	Tobit
Family ownership	-0.943*** (0.031)	-1.032*** (0.036)
Private equity	0.155*** (0.032)	0.170*** (0.367)
Herfindahl index	0.199*** (0.023)	0.220*** (0.027)
First generation	-0.056*** (0.012)	-0.060*** (0.014)
Leadership change	0.031 (0.026)	0.032 (0.024)
Constant	1.194*** (0.020)	1.239*** (0.024)
Number of observations	1,943	1,943
R <sup>2</sup>	0.390	0.466

Note:

Standard errors in parentheses

†  $p < 0.1$ , \*  $p < 0.05$ , \*\*  $p < 0.01$ , \*\*\*  $p < 0.001$

R<sup>2</sup> is adjusted in OLS and pseudo in Tobit

*Corporate governance and internalization strategies*

Table 3. Descriptive statistics and correlation matrix (N = 1,943).

	Mean	S.D.	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)	(15)	VIF
(1) Establishment mode	0.791	0.407																
(2) Non-family board ratio (predicted)	0.531	0.186	-0.055															1.613
(3) Founder	0.351	0.477	0.082	-0.325														1.647
(4) Cultural distance	1.290	0.753	0.074	0.011	0.017													1.265
(5) Geographic distance (log)	7.813	0.959	0.040	0.063	0.036	0.431												1.310
(6) Economic freedom	0.680	0.096	-0.043	-0.005	0.004	-0.151	-0.153											1.209
(7) GDP growth	0.031	0.038	0.096	0.044	-0.023	0.238	0.296	-0.397										1.296
(8) International experience	0.827	0.378	0.134	0.197	-0.028	0.106	0.098	-0.016	0.022									1.076
(9) Parent age (log)	3.238	0.813	0.002	0.266	-0.409	0.020	0.026	-0.085	0.042	0.105								1.819
(10) Parent sales	3.792	12.500	0.043	0.528	-0.198	0.012	0.051	-0.069	0.037	0.130	0.416							1.954
(11) Manufacturing	0.564	0.496	-0.034	-0.232	0.155	0.017	0.069	-0.070	0.071	-0.096	0.041	-0.293						1.237
(12) Non-family leader	0.495	0.500	-0.039	0.270	-0.219	0.038	0.040	0.019	0.005	0.085	0.024	0.252	-0.210					1.225
(13) Board members mean age	55.652	6.347	-0.011	0.238	-0.195	0.035	0.045	-0.036	0.012	0.135	0.337	0.113	-0.097	0.042				1.283
(14) President tenure	10.675	7.181	0.007	-0.162	0.322	0.014	0.006	0.026	-0.067	0.008	0.065	-0.234	0.183	-0.114	0.138			1.360
(15) President woman	0.069	0.253	-0.018	-0.009	-0.099	-0.022	0.011	0.014	0.025	0.008	0.014	-0.066	-0.005	-0.039	0.146	-0.072		1.057
(16) CEO duality	0.456	0.498	0.006	-0.232	0.202	-0.032	-0.010	-0.030	0.031	-0.070	-0.109	-0.244	0.186	-0.300	-0.158	0.115	-0.064	1.185

Note:

Correlation terms higher than |0.064| are significant at the two-tailed 5% statistical level

Correlation terms higher than |0.089| are significant at the two-tailed 1% statistical level

S.D. is standard deviation

Mean VIF is equal to 1.370

Table 4. Regressors' means conditional to the establishment mode.

	Greenfield	Acquisition	Difference
Non-family board ratio (predicted)	0.526	0.551	-0.025**
<i>if Founder = 1</i>	0.452	0.431	0.021
<i>if Founder = 0</i>	0.569	0.597	-0.028*
Founder	0.371	0.275	0.096***
Cultural distance	1.318	1.181	0.137*
Geographic distance (log)	7.832	7.741	0.091†
Economic freedom	0.677	0.688	-0.011*
GDP growth	0.033	0.024	0.009***
International experience	0.854	0.727	0.127***
Parent age (log)	3.239	3.235	0.004
Parent sales	4.068	2.748	1.320†
Manufacturing	0.555	0.600	-0.045
Non-family leader	0.485	0.533	-0.048†
Board members mean age	55.608	55.817	-0.209
President tenure	10.708	10.548	0.160
President woman	0.066	0.079	-0.013
CEO duality	0.458	0.450	0.008

Note:

†  $p < 0.1$ , \*  $p < 0.05$ , \*\*  $p < 0.01$ , \*\*\*  $p < 0.001$

Table 5. Probit models. Dependent variable: Establishment mode (Greenfield = 1).

	(1)	(2)	(4)	(5)
		H1	H2a	H2b
<i>Explanatory variables</i>				
Non-family board ratio (predicted)		-0.994*** (0.217)	-0.864*** (0.223)	-1.414*** (0.267)
Founder			0.225** (0.089)	0.264** (0.091)
Non-family board ratio (predicted) x Founder				1.850*** (0.487)
<i>Country-level controls</i>				
Cultural distance	0.099* (0.050)	0.092† (0.050)	0.092† (0.050)	0.087† (0.050)
Geographic distance (log)	-0.025 (0.039)	-0.021 (0.039)	-0.027 (0.039)	-0.036 (0.040)
Economic freedom	-0.105 (0.379)	-0.033 (0.380)	-0.011 (0.381)	0.010 (0.382)
GDP growth	3.449*** (0.969)	3.703*** (0.976)	3.703*** (0.976)	3.718*** (0.979)
Year dummies	Yes	Yes	Yes	Yes
<i>Firm-level controls</i>				
International experience	0.456*** (0.083)	0.514*** (0.084)	0.502*** (0.084)	0.515*** (0.085)
Parent age (log)	-0.045 (0.047)	-0.038 (0.048)	0.022 (0.053)	0.025 (0.053)
Parent sales	0.006† (0.003)	0.012** (0.004)	0.010* (0.004)	0.013*** (0.004)
Manufacturing	-0.115 (0.073)	-0.136† (0.074)	-0.159* (0.075)	-0.182* (0.076)
<i>Governance-level controls</i>				
Non-family CEO	-0.194** (0.071)	-0.156* (0.071)	-0.127† (0.073)	-0.142† (0.073)
Board members' mean age	-0.008 (0.006)	-0.003 (0.006)	-0.003 (0.006)	-0.001 (0.006)
President's tenure	0.007 (0.005)	0.005 (0.005)	-0.000 (0.005)	-0.000 (0.005)
President woman	-0.069 (0.130)	-0.076 (0.130)	-0.056 (0.131)	-0.029 (0.131)
CEO duality	0.007 (0.071)	-0.010 (0.071)	-0.018 (0.071)	-0.011 (0.072)
Constant	1.130* (0.504)	0.773 (0.513)	0.574 (0.520)	0.587 (0.522)
Number of observations	1,943	1,943	1,943	1,943
Ratio of correct classifications	79.10%	79.05%	79.26%	79.26%
Efron's pseudo R <sup>2</sup>	0.038	0.049	0.052	0.058
Wald test <sup>a</sup>		20.99***	27.18***	42.06***
(degrees of freedom)		(1)	(2)	(3)

Note:

Firm-level clustered standard errors in parentheses

†  $p < 0.1$ , \*  $p < 0.05$ , \*\*  $p < 0.01$ , \*\*\*  $p < 0.001$

<sup>a</sup> Reference model is (1)

Table 6. Average marginal effects of probit models. Dependent variable: Establishment mode (Greenfield = 1).

	(1)	(2)	(3)	(4)
		H1	H2a	H2b
<i>Explanatory variables</i>				
Non-family board ratio (predicted)		-0.272*** (0.059)	-0.236*** (0.060)	-0.230*** (0.060)
Founder			0.062* (0.024)	0.080*** (0.021)
<i>Country-level controls</i>				
Cultural distance	0.028* (0.014)	0.025† (0.014)	0.025† (0.014)	0.024† (0.014)
Geographic distance (log)	-0.007 (0.011)	-0.006 (0.011)	-0.007 (0.011)	-0.010 (0.011)
Economic freedom	-0.029 (0.105)	-0.009 (0.104)	-0.003 (0.104)	0.003 (0.103)
GDP growth	0.957*** (0.267)	1.016*** (0.266)	1.012*** (0.265)	1.007*** (0.263)
Year dummies	Yes	Yes	Yes	Yes
<i>Firm-level controls</i>				
International experience	0.126*** (0.023)	0.141*** (0.023)	0.137*** (0.023)	0.139*** (0.022)
Parent age (log)	-0.013 (0.013)	-0.010 (0.013)	0.006 (0.015)	0.007 (0.014)
Parent sales	0.002† (0.001)	0.003** (0.001)	0.003** (0.001)	0.004*** (0.001)
Manufacturing	-0.032 (0.020)	-0.037† (0.020)	-0.044* (0.020)	-0.049* (0.020)
<i>Governance-level controls</i>				
Non-family leader	-0.054** (0.019)	-0.043* (0.020)	-0.035† (0.020)	-0.039† (0.020)
Board members' mean age	-0.002 (0.002)	-0.001 (0.002)	-0.001 (0.002)	-0.000 (0.002)
President's tenure	0.002 (0.001)	0.001 (0.001)	-0.000 (0.001)	-0.000 (0.001)
President woman	-0.019 (0.036)	-0.021 (0.036)	-0.015 (0.036)	-0.008 (0.035)
CEO duality	0.002 (0.020)	-0.003 (0.020)	-0.005 (0.020)	-0.003 (0.019)
Number of observations	1,943	1,943	1,943	1,943

Note:

Robust standard errors in parentheses

†  $p < 0.1$ , \*  $p < 0.05$ , \*\*  $p < 0.01$ , \*\*\*  $p < 0.001$

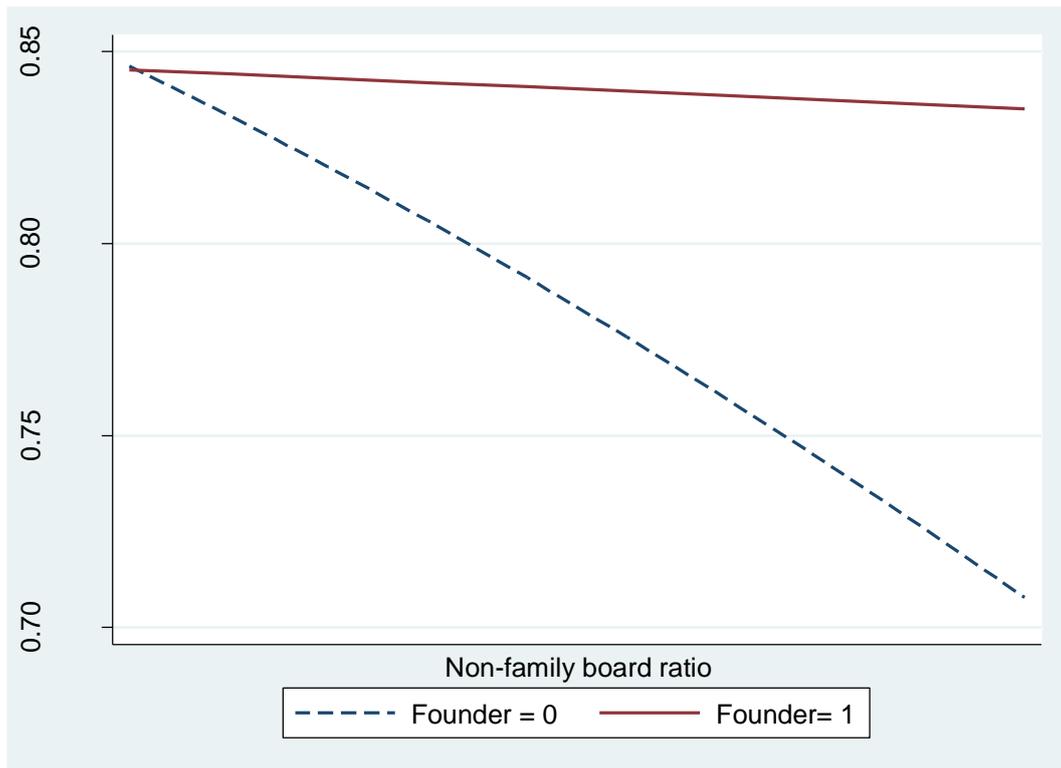


Figure 1. Interaction effect between non-family board ratio and founder on the entry mode (Greenfield = 1).



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**PAPER D. HOW MUCH EMOTIONAL IS SOCIO-EMOTIONAL WEALTH?  
PERFORMANCE AND EMOTIONAL HAZARDS IN FAMILY LEADERS' SUBSIDIARY  
OWNERSHIP POLICIES**

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**ABSTRACT**

Recent applications of behavioral theories into the context of family-controlled firms assert a preference of family decision-makers for strategic actions that allow them Socioemotional Wealth preservation, which ultimately means avoiding losing control of the firm. Relying on a sample of 3,939 foreign subsidiaries run by 586 family-controlled firms, we identify the subsidiary ownership policy as being particularly affected by loss aversion tendencies of family leaders, and investigate trade-offs and interactions between performance and emotional hazards. In doing so, we provide theoretical and empirical evidence that family leaders are either more or less willing to preserve family control – entering the foreign market by a wholly owned subsidiary – depending on whether the firm is exposed to low or high performance hazard. We show how this tendency is either weakened or amplified by the level of emotional hazard, pointing out that when low performance hazard matches with high emotional hazard the family leader's willingness to preserve family control through a WOS is stronger. Finally, we indicate that the influence of emotional hazard on family leader's decision about the subsidiary ownership policy weakens as the cultural distance between the domestic and the foreign country increases.



## **INTRODUCTION**

The study of all fundamental corporate strategic decisions has been traditionally informed by behavioral theories, according to which decision-makers show a preference for those actions that allow them to avoid a loss to their endowment, suggesting that risk bearing is subjective and depends on perceived threats to a decision maker's endowment (March and Shapira, 1987, 1992; Tversky and Kahneman, 1986; Wiseman and Gomez-Mejia, 1998). In recent years, behavioral theories found their second youth in their pervasive application into the context of family-controlled firms (henceforth, family firms). Moving from the seminal work by Gomez-Mejia et al. (2007), scholars started to argue the importance to investigate decision makers' attitudes in family firms. According to these interpretations, family decision-makers (family principals, most often acting in leadership positions) prove to be inherently loss adverse as regard their Socioemotional Wealth (SEW), i.e., the affective endowments or nonfinancial aspects of the family business. Preserving family SEW is a key goal for family decision-makers and attaining this goal requires primarily to retain firm's control, since ownership enables the family to realize its interest through the firm (Gomez-Mejia et al., 2007; Zellweger et al., 2012). Scholars investigated the impact of SEW preservation on decisions such as environmental performance (Berrone et al., 2010), diversification strategies (Gomez-Mejia, Makri and Larraza-Kintana 2010), IPO underpricing (Leitterstorf and Rau, 2014), international acquisition near the end of a CEO's career horizon (Strike et al., 2015), and R&D investment decisions (Patel and Chrisman, 2014), among others. All these studies implicitly or explicitly assumed that, for family principals, major managerial decisions are driven by the wish to avoid family control losses, even if achieving this goal might entail a higher financial risk or a reduced performance. At the same time, recent findings and a more fine-grained conceptualization of SEW sustain a situational approach of risk preferences in family firms, according to which family control loss aversion varies depending on various circumstances, among whom the level of performance hazard is one of the most important (Gomez-Mejia et al., 2007; Gomez-Mejia, Makri and Larraza-Kintana, 2010; Minichilli, Brogi and Calabrò, 2015). We confirm and expand this idea by investigating family leaders' decisions on the subsidiary ownership policy, i.e., the choice of either setting up a Wholly-Owned Subsidiary (WOS)

or forming a Joint Venture (JV) in a foreign country (Hennart and Larimo, 1998). This choice, we believe, is particularly appropriate to investigate the family leaders' control loss aversion, and hence to explore trade-offs and interactions between performance and emotional hazards. More in detail, first we show how the level of performance hazard influences the family leaders' decision on the extent of control they want to keep in the subsidiary; second, we find that relation is either mitigated or reinforced depending on the level of emotional hazard and the cultural distance between the domestic and the foreign market.

The subsidiary ownership policy is a key strategic decision for all firms (e.g. Brouthers, Brouthers and Wernen, 2003; Guillén, 2003; Hennart and Larimo, 1998; Makino and Neupert, 2000). We argue it may become of paramount importance in family firms where the strategic ingredient of the subsidiary ownership policy is blended with emotional drivers of family leaders' choices. We believe family leaders to be sensitive to this strategic choice due to the *exclusive* versus *shared* control that the corporate firm will have over the foreign investments in the case, respectively, of a WOS as opposed to a JV (Brouthers, 2013). Because the family control on the subsidiary can be considered as a prolongation of the family control on the parent company, we argue that the subsidiary ownership policy is an ideal context to investigate family leaders risk preferences in front of an important strategic decision that triggers their loss aversion behavior. The investigation of this strategic decision also allows us to consider how the family control loss aversion varies depending on international context-related differences – specifically, cultural distance – which received only little attention by prior studies on family firms insofar (Gomez-Mejia et al., 2010). Accordingly, answering the following research questions might be particularly important to understand how the family control loss aversion has a different intensity depending on certain circumstances: *How does the level of performance hazard influence the strategic decision that family leaders make on subsidiary ownership policy? Moreover, does this decision vary when the performance hazard is coupled with emotional hazard and when the foreign country is culturally distant from the domestic one?*

Whereas the prevailing SEW assumptions would suggest family leaders to enter into a foreign country through a WOS to avoid a dilution in family's control (Gomez-Mejia et al., 2011), we expand

this argument building on the notion that family control loss aversion has a weaker role in driving strategic decision-making as external hazards step in (Gomez-Mejia, Makri and Larraza-Kintana 2010; Gomez-Mejia et al., 2011; Minichilli, Brogi and Calabrò, 2015). However, while previous studies assumed a situational validity of SEW preservation mostly from a theoretical standpoint (e.g. Minichilli, Brogi and Calabrò, 2015), we theoretically argue and empirically investigate variations in family leaders strategic decisions depending on the level of performance hazard, emotional hazard and cultural distance.

Based on evidence from a sample of 3,939 subsidiary ownership policies run by 586 family firms, we show that family leaders switch from a high-loss aversion to low-loss aversion behavior in presence of persistent performance hazard. Depending on whether firm performance is improving or declining (Gomez-Mejia, Makri and Larraza-Kintana, 2010; Gomez-Mejia, Patel and Zellweger, 2015), the family leader is more or less driven by the desire to preserve family control when making strategic decisions and, therefore, more or less likely to enter a foreign market through a WOS. We also find that the above tendency is either weakened or amplified by the level of emotional hazard, indicating that when low performance hazard matches with high emotional hazard the family leader's willingness to preserve family control through a WOS is stronger. Moreover, we show that the impact of emotional hazard on family leader's choice about the subsidiary ownership policy weakens as the cultural distance between the domestic and the foreign country increases. It supports our idea that moving from the domestic to a culturally distant foreign context there is a loss of emphasis on family control preservation due to a weaker role of SEW social dimension (Miller and Le Breton-Miller, 2014).

Our study contributes to prior literature by investigating the role of family control loss aversion – stemming from the main goal of SEW preservation – in driving family leaders' strategic decisions overseas (e.g. Boellis et al., 2016; Brouthers and Hennart, 2007; Filatotchev et al., 2007; Hennart and Slangen, 2014; Hill, Hwang and Kim, 1990). We confirm and expand the notion that the loss aversion for family leaders has a different intensity depending on certain circumstances (Gomez-Mejia, Makri and Larraza-Kintana, 2010) by highlighting that their strategic decisions substantially vary based on

how those circumstances occur. In doing so, we contribute to a deeper understanding of behavioral theories specifically in the context of family decision-makers, by providing evidence that the family leader's loss aversion is either strengthened or weakened depending on the level of performance hazard, emotional hazard and cultural distance, with subsequently different strategic choices. Altogether, our results give a comprehensive picture about the determinants of strategic decision-making in family firms, providing a more articulated interpretation of the "emotional" component of SEW.

### **THE SUBSIDIARY OWNERSHIP POLICY: A SEW PERSPECTIVE**

When establishing a subsidiary abroad, firms can start up new ventures or acquire existing ones (Brouthers and Brouthers, 2000; Hennart and Slangen, 2007). In both cases firms can set up a subsidiary they own completely (WOS) or form joint ventures (JV) with partners: the choice between a fully or only partially owned affiliate is usually named in literature as subsidiary ownership policy (Brouthers and Hennart, 2007) and received uncommonly high attention by international business scholars. This attention is motivated by the several implications of ownership choice over a number of issues such as sourcing strategies, transfer pricing, integration of the firm's worldwide activities and, ultimately, the subsidiary performance (Erramilli, 1996).

Prior studies have extensively built on transaction cost theory to explain the choice between WOS and JV (e.g. Brouthers, Brouthers and Werner, 2003; Guillen, 2003; Makino and Neupert, 2000), suggesting that a JV is preferred to a WOS when the investing firm needs to obtain complementary assets leveraging on a local partner. Other studies also emphasized the relevance of non-transaction cost factors such as host government restrictions, host country risk and uncertainty, firm nationality, as well as other strategic factors (Brouthers, 2013; Chari and Chang, 2009; Delios and Beamish, 1999; Gomes-Casseres, 1990; Hill, Hwang and Kim, 1990). Indeed, subsidiary ownership policies could be a very complex function of numerous factors including host country, industry, product, and firm characteristics. A transaction cost perspective cannot fully explain all the antecedents (Makino and Neupert, 2000), especially in the case of family firms. Due to their need to

balance business and family demands and the consequent joint presence of both economic and noneconomic goals (e.g. Chrisman, Chua and Litz, 2004; Chrisman et al., 2012), the way family decision-makers manage internationalization may be unique (Banalieva and Eddleston, 2011; Boellis et al., 2016). Prior literature indicated that, while family leaders carefully consider the economic consequences of their strategic decisions, noneconomic consequences are often likely to play a major role (e.g. Gomez-Mejia et al., 2007; Gomez-Mejia et al., 2011). In other terms, in assessing the relative risk of various strategic choices, family leaders have an additional reference point compared to outside executives with no emotional ties with the company, which is exactly the SEW preservation. SEW preservation is realized through family control maintenance, and family control loss aversion drives the family leader's choice even if alternatives would confer some business risk mitigation (Gomez-Mejia et al., 2007; Gomez-Mejia, Makri and Larraza-Kintana, 2010), or imply an economic gain (Leitterstorf and Rau, 2014). This behavioral logic was first explored by Gomez-Mejia et al. (2007), who provided evidence that Spanish family olive oil mills were less likely to join cooperatives, thus accepting higher business risk in order to avoid family control dilution. Later on, Gomez-Mejia, Makri and Larraza-Kintana (2010) similarly demonstrated that family firms diversify less than non-family firms since diversification threatens SEW and weakens family power and control.

Under this theoretical lens, internationalization may carry a tricky bundle of threats for the SEW preservation (Gomez-Mejia et al., 2011). We suggest that subsidiary ownership policy might be especially challenging for a family leader since it entails a major decision about either preserving family control - and associated SEW - in a foreign country, or rather sharing it with an external partner. According to the SEW preservation logic, the strategic choice that better enables to maintain family control will prevail over alternative decisions (Gomez-Mejia et al., 2007; Gomez-Mejia, Makri and Larraza-Kintana, 2010): along this logic, it is reasonable to argue a family leaders' preference for WOSs since they guarantee family control maintenance and, therefore, SEW preservation more than JVs – which could be instead considered as a way to dilute family holdings (Gomez Mejjia et al., 2011). However, a deeper understanding of SEW conceptualization suggests that family control loss

aversion has a different intensity in driving family leaders behavior depending on circumstances surrounding strategic decisions (Gomez-Mejia et al., 2011; Minichilli, Brogi and Calabrò, 2015). Following this logic, we aim at understanding whether the family leader's willing to protect family control through a WOS varies based on the level of performance hazard, emotional hazard, and cultural distance.

### **Family control loss aversion and performance hazard**

The idea that performance hazard mitigates SEW preservation goals was first explored by the very same study that first introduced SEW. Gomez-Mejia and his colleagues (2007) showed indeed that family-owned olive oil mills were more likely accept family control losses when the volume of sales was suffering a substantial downward trend. Later on, Gomez-Mejia, Makri and Larraza-Kintana (2010) found that large publicly traded family firms have a higher proclivity for diversification – thus accepting family control losses – as the firm performance decreases. Hence, depending on whether firm performance is improving or declining, i.e., on the level of performance hazard, SEW preservation goal will have a different intensity (Gomez-Mejia et al., 2007; Gomez-Mejia, Makri and Larraza-Kintana, 2010). While family leaders will consider SEW preservation an important reference point under good performance trend, that goal will have lower emphasis if the firm is experiencing an hazard: “if the firm fails to survive, SEW would be completely lost, and given this possibility the relative utility of preserving SEW at the expenses of bearing higher business risk should decline accordingly” (Gomez-Mejia, Makri and Larraza-Kintana, 2010: 232). Put it differently, the family control loss aversion will have a different weight in driving family leader decisions depending on the level of performance hazard. Along this line, we suggest that the choice JV vs. WOS for family leaders will depend on whether the family firm is experiencing a performance hazard or not. Hence, we propose that a family leader's behavior will switch from a high family control loss aversion to a low family control loss aversion as a substantial performance hazard steps in (Minichilli, Brogi and Calabrò, 2015).

More in detail, when the family firm investing abroad is suffering from low performance, the family leader will be less focused on noneconomic goals (Gomez Mejjia et al., 2011) and thus less

adverse to dilute family control through a JV: mitigating that performance hazard to safeguard SEW in a long term perspective will be a priority. Since it allows to share business risk with an external party and restrains the investment (Brouthers and Hennart, 2007), a JV is supposed to be in line with that priority. On the contrary, when the family firm is experiencing positive performance, the family control loss aversion will play a pivotal role in driving the decision-maker towards WOS, in order to keep the entire family control over the foreign investment. Hence, we hypothesize that:

***Hypothesis 1 (H1):** The level of performance hazard affects the family firms' subsidiary ownership policy: Under low performance hazard, the family leader will be more likely to choose WOS, while under high performance hazard s/he will be more likely to choose JV.*

### **Family control loss aversion and emotional hazard**

Family identity refers to the close identification of the family with the firm (Berrone, Cruz and Gomez-Mejia, 2012; Gomez-Mejia, Cruz and Imperatore, 2014). The family identity acts as a glue for family members, holding the group together under the common goal and the common pride of the fulfillment of family firm obligations so that the family and the organization are inextricably intermeshed (Dyer and Whetten, 2006; Berrone et al., 2010; Zellweger et al., 2010; Zellweger et al., 2013). Kinship ties and a common history have the unique potential to build a robust family identity in family firms, encouraging family members to support family goals (Sundaramurthy and Kreiner, 2008; Zellweger et al., 2010).

The identity of family members within the family business is inseparably tied to the firm when it carries the family's name: it induces the firm to be seen as a prolongation of the family itself both by internal and external stakeholders (Berrone et al., 2010). Indeed, when the family's name corresponds to the company's name the family is highly visible in the company and strongly associated to the business (Craig, Dibbrell and Davis, 2008; Belenzon, Chatterji and Daley, 2014). The higher the visibility of the family in the business, as in the case of identical family and company names, the more blurred the boundaries between the family and the business (Deephouse and Jaskiewicz, 2013; Zellweger et al., 2013) with the consequence that firm's behavior will have direct

repercussion to the family. In this line, we suggest that high identity family firms face higher emotional hazard since they have a lot at stake in terms of emotional entrenchment: as such, the family leader will be more sensitive to make strategic decisions in line with family's interests and in order to protect the family's endowment. Indeed, whether or not the family strives for a family identity should explain the family firm's pursuit of nonfinancial goals (Zellweger et al., 2013): the importance of SEW preservation arise from identity consideration and it is anchored by family members whose identity is bound to the organization (Berrone et al., 2010). Building on the idea that strategic behaviors in family firms may differ based on the family-specific focus on SEW preservation (DeTienne and Chirico, 2013), we suggest higher family control loss aversion for those family leaders operating in firms that exhibit a strong family identity i.e., facing higher emotional hazard.

Specifically, we argue the emotional hazard stemming from family identity may either mitigate or reinforce the relation between high or low performance hazard, and the related family leaders' lower or higher propensity for a WOS. As we argued above, low performance hazard will drive family leaders to choose consistently with their loss aversion attitude – i.e., selecting a WOS (Gomez-Mejia, Makri and Larraza-Kintana, 2010; Gomez-Mejia et al., 2011); and the SEW preservation attitude will be further reinforced in presence of higher emotional hazard (i.e., in firms with identical family and company names). On the contrary, when the firm is experiencing a high performance hazard, noneconomic goals are supposed to make way for economic considerations (Gomez-Mejia, Makri and Larraza-Kintana, 2010), with family control loss aversion no longer being the key priority: reduced emphasis on noneconomic goals for firms experiencing performance hazard will be further reduced when it matches with a low level of emotional hazard, making the likelihood of WOS even lower. Therefore, we argue:

***Hypothesis 2 (H2):*** *The family leader has a stronger positive relation with WOS when the firm is characterized by low performance hazard and high emotional hazard. At the opposite, the family leader has a stronger negative relation with WOS when the firm is characterized by high performance hazard and low emotional hazard.*

### **Emotional hazard and cultural distance**

The last part of our investigation takes into account the role of cultural distance, namely the difference between the national cultural characteristic of the domestic and the foreign country (Hennart and Larimo, 1998). Although prior studies do not have a common opinion on whether cultural distance enhances the propensity to choose WOSs rather than JVs (e.g. Anand and Delios, 1997; Chang and Rosenzweig, 2001; Pak and Park, 2004), scholars do agree that cultural distance does influence the subsidiary ownership policy according to the idea that “the cultural context helps to define profit potential and/or the risk associated with a specific market entry” (Brouthers and Brouthers, 2000: 91). A great cultural distance between home and host countries generates constraints for foreign investors that want to operate in the host country (Arora and Fosfuri, 2000; Hennart and Larimo, 1998).

The role of cultural distance might be especially complex for family leaders’ decision-making since it has the potential to challenge the family identity in its external side and, consequently, the role that emotional hazard plays in driving family leader’ decisions. Zellweger et al. (2010, 2013) suggested that family identity makes the family firm particularly careful about the way it is perceived by non-family stakeholders outside the company. Therefore, emotional hazard also reflects the risk that the family faces in terms of reputation, image and social legitimacy, which are all core concerns for family members (Berrone et al., 2010). Family leaders usually live near the local community and become well known to individuals in that context such that they are likely to perceive external pressures also from a personal point of view: depending on the level of family identity, the family leader “speaking for the firm” (Miller, Minichilli and Corbetta, 2013) will be more or less sensitive about the image the family firm has externally (Zellweger et al., 2013).

However, family leaders who usually live in their local community become well known individuals, gaining personal and family noneconomic advantage from their local relations in that community (Berrone et al., 2010). The family firm, its tradition, and its family system are instead usually mostly unknown in a foreign country. We argue that family leaders might be less willing to gain social legitimacy from local stakeholders in a foreign country, especially if that country is

culturally distant from the domestic one (Hennart and Larimo, 1998). More precisely, we suggest that when a family leader operates in a culturally distant foreign country, he or she will be less sensitive to social pressures from the foreign context as well as its community even in the presence of a strong family identity, which exposes family principals to high emotional hazard. As the cultural distance between the home and the host country increases, the role of emotional hazard to reinforce the SEW preservation goal and the family control loss aversion weakens: we believe the family leader will be less likely to enter the foreign market through a WOS. Hence, we posit:

***Hypothesis 3 (H3):** Cultural distance weakens the role of emotional hazard in front of the subsidiary ownership policy: when the firm is characterized by high emotional hazard, the family leader will be less likely to enter a foreign market through a WOS as the cultural distance between the domestic and the foreign country increases.*

## **METHODS**

### **Sample**

The level of analysis of the study is the foreign entry. The estimates rely on a unique data set covering internationalized Italian family firms (i.e., that undertake at least one foreign direct investment, FDI) with more than 50 million of euros of revenues. We employ several sources to build the data set. First, accounting and financial data are retrieved from AIDA, the Italian branch of the Bureau van Dijk data provider. Then, we match financial data with governance information obtained from official public filings stored at the Italian Chamber of Commerce (Amore, Garofalo and Minichilli, 2014). Finally, we built data on FDIs from the Reprint data set (Boellis et al., 2016), which lists information on foreign entries undertaken by large Italian firms worldwide. Such data are obtained from the companies' annual reports and crosschecked with press releases, newspapers and company websites. Information on individual characteristics come from sources such as the annual corporate governance report, the company website, the Italian Who's Who list of top executives, and articles from the specialized press (Minichilli, Brogi and Calabrò, 2015). The threshold of 50 million

of euros of revenues allows considering only medium and large firms, thus assuring a high availability of information about both the firm and the foreign entry. Furthermore, in line with international business literature (Cho and Padmanabhan, 1995; Hennart and Reddy, 1997), we study one single home country, in order to avoid biases due to the impact of home country national differences on the entry mode.

Following existing studies, we define family firms according to the equity share that is held by family members that allows controlling the firm (Faccio and Lang, 2002; Anderson and Reeb, 2003). Since concentrated ownership structures are common in Italy, we argue that a stake of 50 percent is required to control the firm (Miller, Minichilli and Corbetta, 2013). However, if the parent firm is listed, the threshold for control is reduced to 25 percent of equity. With the selected criteria, we obtain a final sample consisting of 3,939 foreign entries run by 586 family firms, undertaken between 1995 and 2013 in 27 different countries.

### **Dependent variable**

*Wholly-owned subsidiary (WOS)*. Coherently with previous studies (Makino and Neupert, 2000; Brouthers, 2013), we discriminate between WOS and JV according to the equity stake that the parent firm controls into the subsidiary. Namely, if the parent owns more than 95 percent of the equity's foreign subsidiary, we classify it as a WOS; otherwise, we consider it as a JV. Operationally, the dependent variable is a dummy that takes value 1 when the foreign entry is a WOS, and 0 when it is a JV.

### **Main explanatory variables**

*Family leader*. Within family firms, we distinguish those that are family led and those that are led by an individual who is not a family member. The firm leader is the individual who has been appointed as a CEO, executive president or leader without a formal board of directors (Miller, Minichilli and Corbetta, 2013). Family members are those with blood or marital ties to the owning family, identified through surname affinity (Amore, Garofalo and Minichilli, 2014). When the firm is family led, the variable takes value 1; otherwise, it is 0.

*Cultural distance.* Cultural distance is a widely employed concept in the international business literature, despite some authors have highlighted that it is affected by theoretical and empirical pitfalls (Shenkar, 2001; Avloniti and Filippaios, 2014). Specifically, one of the problems associated with cultural distance measurement is that it assumes stability over time, whilst cultures evolve and co-evolve (Shenkar, 2001). To remove this illusion of stability, we rely on Berry, Guillen and Zhou (2010) variables. Indeed, they employ the World Value Survey (Inglehart, 2004) to replicate Hofstede's (1980) dimensions at specified interval of times (i.e., three or four years). In such a way, it is possible to observe how cultural distances change over time. Finally, the four dimensions are grouped in a single index through the Mahalanobis calculation (De Maesschalck, Jouan-Rimbaud and Massart, 2000), because it is scale invariant and takes into account the variance-covariance matrix. Finally, values are standardized. More specifically:

$$Cultural\ distance = \sqrt{\frac{1}{4} \sum_{i=1}^4 (x_{i,j} - \mu_i)^T S^{-1} (x_{i,j} - \mu_i)}$$

where:

$x_{i,j}$  is the cultural distance for the  $i$ -th dimension between Italy and the  $j$ -th country;

$\mu_i$  is the mean distance for the  $i$ -th dimension of cultural distance;

$S$  is the distances' variance-covariance matrix.

### **Control variables**

We employ a set of variables in the econometric models in order to control for several determinants of the subsidiary ownership policy and to avoid potential endogeneity issues due to omitted variables. In particular, we distinguish between firm-level controls (that refer to the parent company) and country-level controls (that are specific of the host country of the foreign entry).

*Firm-level controls.*

*Parent age* is the difference between the year of the foreign entry and the parent's foundation year. The former is retrieved from Reprint and the latter from AIDA – Bureau van Dijk. We expect that older firms should possess more financial and managerial resources that would lower the need of

having a partner, hence increasing the WOS propensity. *Parent size* is measured with the number of employees recorded by the parent firm in the year of the investment. The value is log-transformed due to the right-skewed distribution. Data are taken from AIDA – Bureau van Dijk. As for age, size is a proxy of the presence of resources constituting a competitive advantage in international markets that would augment the probability of establishing WOSs. *Leverage*. Financial constraints may affect the subsidiary ownership policy, since the lack of financial resource may hamper the equity stake held in the foreign firm. We then predict that lower leverage should favor WOSs. We control for this aspect considering the parent's leverage ratio. It is computed as the ratio between outstanding debt and equity. Data are taken from AIDA – Bureau van Dijk. *R&D intensity* is the ratio between the R&D expenses and the total sales. Data are log-transformed because of the right skewness of the distribution. It is a proxy of the firm's asset specificity. The higher the asset specificity the higher the need to protect it, thus favoring WOSs. Data on R&D expenses and total sales come from the annual reports. *Family control*. The power and pressure that the family leader may exercise over the family firm depend also on the control that the family has within the equity base. We control for this aspect through the ratio of family controlled shares. Data come from the Italian Chamber of Commerce. *First generation*. We distinguish among the family generations who run the family firm. In particular, we dichotomize between family firms run by the first generation and those controlled by later generation. For the former, this variable takes value 1; the latter are codified by 0. *Female leader*. It has been shown that gender interactions have relevance in decision making, with particular reference to family firms (Amore, Garofalo and Minichilli, 2014). For this reason, we control for gender by creating a dummy variable that has value 1 when the leader is a female and 0 when he is a male. *Leader tenure*. Leaders with long tenure have strengthened their power over the firm and, thus, they are able to leverage on their tenure to drive the firm's strategies towards their preferred ones. We control this aspect by inserting the number of years that the individual has been running the family firms as a leader. Data come from company reports, the Italian Chamber of Commerce, AIDA – Bureau van Dijk and Who's Who.

*Country-level controls.*

*Country risk* plays a central role in the choice of the subsidiary ownership. Indeed, it is reasonable to enter countries that are exposed to higher political risks with a partner, in order to share the country risk. We rely on classification developed by OECD (2015), which lists countries according to both a quantitative and a qualitative risk evaluation and then assigns a risk factor that ranges between 0 (lower risk) to 7 (higher risk). *Administrative distance* accounts for differences in bureaucratic patterns due to colonial ties, language, religion, and the legal system (Berry, Guillen and Zhou, 2010). They rely on the colonizer-colonized link, common language between the home and the host country, common religion, and commonalities in legal systems (La Porta, Lopez de Silanes, and Shiefler, 1999). The Mahalanobis distance is then calculated in order to create a single index. Values are standardized as for cultural distance. Specifically:

$$\text{Administrative distance} = \sqrt{\frac{1}{4} \sum_{l=1}^4 (y_{l,j} - \pi_l)^T V^{-1} (y_{l,j} - \pi_l)}$$

where:

$y_{l,j}$  is the administrative distance for the  $l$ -th dimension between Italy and the  $j$ -th country;

$\pi_l$  is the mean distance for the  $l$ -th dimension of administrative distance;

$V$  is the distances' variance-covariance matrix.

*Geographic distance* is the great circle distance between Italy and foreign country's capitals. It takes account of transportation costs, time zones, and the like. It is retrieved from the Wharton database by Berry, Guillen and Zhou (2010). We express it in thousands of kilometers.

## **Model**

The dependent variable *WOS* is dichotomous, thus we employ probit models to analyze the impact of the aforementioned regressors on the likelihood of choosing a *WOS* rather than a *JV*, since they constrain the domain of the predicted values between 0 and 1. We employ a two-way fixed-effects model for the regression analyses. The first set of fixed effects refers to two-digit NACE code

industry dummies, while the second set refers to time fixed effects and distinguishes among foreign entries run between 1995 and 2000, between 2001 and 2007, and between 2008 and 2013. However, since most of the firms run more than one foreign entry, we allow correlation among observations from the same company in order to relax the assumption of independence across observations. Consequently, we cluster standard errors at the firm level. Finally, we do not use panel models because the same firm may run some foreign entries in one year and no one in other years. Therefore, the sample has the structure of a repeated cross-section, rather than a panel (Cameron and Trivedi, 2005).

In order to test the hypotheses, we run the models on the theoretically relevant sub-samples<sup>25</sup>. In particular, we distinguish the sub-samples along two dimensions: i) performance hazard and ii) emotional hazard. To capture the first dimension, we rely on existent literature on performance hazard in family firms. Following Gomez-Mejia et al. (2010), performance hazard represents the extent to which the performance of the firm is improving or declining. We then calculate performance hazard as one minus the natural logarithm of the ratio of firm performance (in terms of ROA) at time  $t$  and that at time  $t - 1$ . Finally, we discriminate between firms with low performance hazard (i.e., firm's performance is improving) and high performance hazard (i.e., firm's performance is stable or declining). We capture the second dimension by discriminating firms with high emotional hazard (i.e., when the family name is present in the company name – e.g. Barilla, Benetton or Ferragamo) and low emotional hazard (i.e., when the company name differs from the family name – e.g. Mediaset with the Berlusconi family and Brembo with the Bombassei family).

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<sup>25</sup> This method brings two benefits compared to interact the variables. First, it allows the controls to vary freely across the subsample, whilst employing a single model with interactions would tacitly assume that the control have the same impact on the different categories. Second, since we investigate several dimensions – i.e., family leader, cultural distance, and two hazard types (performance and emotional) – the number of interactions would be of difficult interpretation.

## **RESULTS**

Table 1 provides the geographical distribution of the foreign entries and the average foreign entry per firm. In addition to show a clear picture of the sample distribution, we aim at investigating two potential issues. First, we wonder whether there are countries that exhibit frequencies that are not economically driven. If this was the case, our estimates could suffer of selection biases and of underestimating the real economic drivers of the subsidiary ownership policies. Second, we analyze whether family and non-family leaders show divergences in host country selection, since it would be worth investigating the reasons in order to avoid biasing the results. With reference to the first point, we note that the three most entered countries are China, the United States and Germany, which are the main Asian, American and European economies, respectively. In particular, 49.97 percent of the foreign entries in the sample have these countries as their destinations; according to the World Bank, the same countries account for the 40.62 percent of the World GDP in 2014. Further, looking at the other countries, none of them is significantly over/underestimated with regard to its economics relevance and the economic relations with Italy. Moving to the preferences between family and non-family led firms, we see that there is few variance by country. Specifically, the country where the discrepancy is the highest is the United States where, although total foreign entries in this country account for the 18.66 percent of the cases, family led firms show a 16.10 percent. Such a variance appears physiological to us.

With regard to the number of foreign entries and firms, at a first glance, we note that family led firms overcome their non-family counterparts in terms of foreign entries (2,403 vs. 1,536). However, if we compute the average foreign entry per firm, we note that the former run 5.21 foreign entry per firm, while the latter reach a mean of 12.29. This result is consistent with previous studies that relate higher level of family involvement with lower level of international diversification and activity (Banalieva and Eddleston, 2011; Gomez-Mejia, Makri and Larraza-Kintana, 2010;).

*[Insert Table 1 about here]*

We report in Table 2 the descriptive statistics of the variables, jointly with the pairwise correlations. We observe that family firms opt for WOSs in the 74.7 percent of the foreign entries.

This finding is consistent with analogous studies that employed the same thresholds of 95 percent to distinguish between WOSs and JVs. Indeed, Brouthers (2013) finds that the 70 percent of the foreign entries are WOSs; Hennart, Sheng and Pimenta (2015) report that 84 percent of foreign entries are WOSs. Parent age mean is equal to 43.8 years, but standard deviation is quite high, since our sample ranges from newly established ventures to more than a century old companies. Mean leverage has a value of 3.884. However, leverage can vary massively (standard deviation is 3.642), since it often relies on firm and industry peculiarities, according to the corporate capital structure theory (Leary and Roberts, 2014). Further, families have a tight control on the family firms (77.1 percent of the equity on average). This is not surprisingly due to the high threshold that we select to identify family control in such a concentrated market for corporate control as Italy is. Moreover, 46.3 percent of the investments come from family firms controlled by family members in the first generation. Finally, in spite of mean leader tenure of 12 years, the highest tenure reaches 49 years. Although it may seem a long period, it refers to the founder of a family firm, who holds the role of CEO since the firm's inception.

Moving to the correlations, we observe that, despite few exceptions, they are at moderate levels. When correlation seems high – in absolute terms –, it does not worry us. For instance, the largest value is -0.564, the correlation between family control and parent size. It seems reasonable that when a firm grows, it requires to finance such a growth and family may not be able to bear it, thus diluting control. However, to chase all doubts away, we compute the variance inflator factor (VIF). Results may suffer of multicollinearity if such a factor exceeds 10 for any single variable or if the mean VIF is higher than 6 (Hair et al., 2009). We are far from such thresholds, since the maximum VIF is 2.264 for parent size and the mean VIF is equal to 1.407.

*[Insert Table 2 about here]*

Panels A and B of Table 3 provide us a rough approximation of the WOS distribution, conditional to the performance and emotional hazards, for family and non-family managed firms, respectively. To start with, we observe that – regardless of the family identity – family leaders of firms with high performance hazard run less WOSs (67.60 percent) than their counterparts with low

performance hazard do (78.49 percent). The difference is highly significant and in the same direction of hypothesis 1. When experiencing a high performance hazard, family leaders are less averse to share the subsidiary's control with a partner. If we compare it with the non-family leaders in panel B, we observe that the JV propensity difference between high and low performance hazard is negligible and not significant; therefore, we can assume that the SEW preservation by family leaders becomes less relevant for firms with high performance hazard, as expected. We also posit that, when emotional hazard is high, family leaders prefer avoiding having a partner. Indeed, regardless of the performance hazard, family leaders opt for WOSs in the 77.50 percent of cases when emotional hazard is high and 69.92 percent when it is low. Again, the difference is strongly significant. On the other hand, non-family leaders behave differently with regard to emotional hazard. In particular, given the lower stock of family-related endowment, it arises that they counter-balance the preference to retain control over the subsidiary. We now examine the four combination of performance and emotional hazards. It clearly emerges that we have two opposite focal points. Having said that firms with low performance hazard share with those with high emotional hazard the preference for WOSs, it is reasonable that those firms that combine the two characteristics report the highest ratio of WOSs (84.24 percent). These firms undertake more WOSs than those with which share the same level of emotional hazard, but not the same of performance hazard (68.90 percent). The same is true with reference to those that have low performance hazard too, but low emotional hazard (74.02 percent). Each difference is statistically significant. On the opposite corner of the table, we have those firms whose hazards' levels hamper WOSs – i.e., they have high performance hazard and low emotional hazard. As a result, these firms report the lowest probability to opt for a WOS (67.09 percent). However, the difference with the firms with whom share one hazard is statistically weak (if they report the same level of emotional hazard identity) or negligible (if they report the same level of performance hazard). For the sake of brevity, we do not dwell upon the combination in non-family led firms in panel B, but we simply note that, as one would expect, the statistics are symmetrical to those of family led firms<sup>26</sup>.

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<sup>26</sup> Non-family leaders report specular preferences compared to the family one. In particular, they show the highest propensity for WOS when the firm has high performance hazard and low emotional hazard (79.87 percent). On the contrary, when the firm has low performance hazard and it has high emotional hazard, the show a weaker preference for

[Insert Table 3 panel A and panel B about here]

Econometric analyses are scheduled as follows. Table 4 reports the econometric estimates for the full sample and the two sub-samples distinguishing between high and low levels of performance hazard. Strictly related, Table 5 reports the average marginal effects<sup>27</sup> for the same models. Analogously, Table 6 reports the estimates for high and low identity firms, while Table 7 incorporates the average marginal effects. Finally, Table 8 and Table 9 show the estimates and average marginal effects, respectively, of the four possible combinations of performance mode and identity status.

We first analyze some relevant controls. Parent age and size, when significant, have positive signs in every table. It confirms our expectation that, *ceteris paribus*, older and larger firms have managerial and financial resources to follow a WOS-based strategy, in compliance with family firms' preferences. The magnitude of the effect is especially relevant for size, as its one percent increase (decrease) leads to an increase (decrease) of the probability of WOS between 2.1 and 6.3 percent, across the sub-samples. The opposite is true for leverage. Coefficients, when significant, are always negative, meaning that more leveraged firms are less likely to establish WOS. This is coherent with the expectation that leveraged firms face more difficulties to raise money to internationalize and, thus, they face financial constraints that leads to share the foreign venture with a partner. However, the magnitude is weak, as a unitary increase in leverage leads to roughly 1 percent decrease of WOS probability in the different sub-samples. Moreover, we report that the coefficient of the first generation dummy is always positive, when significant. We explain this effect by assuming that first generation family members show a tighter relation with the family firm and, thus, prefer avoiding

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WOS (66.10 percent). Furthermore, the differences along the quarters are rarely significant; therefore, we can confirm that the findings are driven mainly by the family leaders' behaviour, rather than from their non-family counterparts.

<sup>27</sup> For floating variables (i.e., parent age, leverage, family ownership, tenure leader, country risk, geographical distance), average marginal effects have to be interpreted as the average increase (decrease) in probability to run a WOS – compared to undertaking a JV – due to a unitary increase (decrease) of the independent variable. For standardized variables (i.e., cultural distance and administrative distance), average marginal effects refer to the average impact on the dependent variable of a one standard deviation variation, rather than a unitary change. For dummy variables (i.e., family leader, first generation, and female leader), they are the difference between the presence and absence of the condition indicated by the dummy. Finally, for log-transformed variables (i.e., parent age and R&D intensity), average marginal effects have to be interpreted as semi-elasticities, that is the average effect on the WOS probability of one percent change of the independent variable.

establishing foreign subsidiaries with a partner. These firms are 5.1-11.2 percent more likely to establish a WOS than those held by family members of later generations.

From the last rows in Table 4, it emerges that the full sample consists of 3,939 foreign entries run by 586 firms, an average of 6.72 FDI per firm. The same statistics for firms with high and low performance hazard are 7.21 and 6.46, respectively. This is coherent with the expectation that well performing firms have more resources to invest abroad and, thus, they do it more often. The impact of family leader in the full model is not significant and with negligible magnitude (the average marginal effect – not significant – is 1.1 percent). However, when we split the sample according to the performance hazard, we note that such a weak effect is the result of a match between a positive (coef. = 0.426; p-value = 0.019) impact on WOS for those firms with low performance hazard and a negative one (coef. = -0.310; p-value = 0.015) for those with high performance hazard, as reported in models (4) and (6), respectively. Specifically, family leaders of firms with low performance hazard show a 10.7 percent higher probability of running a WOS than their non-family counterparts do. On the contrary, they lower such a probability by 9.5 percent when the firm have high performance hazard (see Table 5). This finding provides clear support for H1.

*[Insert Table 4 about here]*

*[Insert Table 5 about here]*

Focusing on emotional hazard, from Table 6 we observe that it does not affect the proclivity to internationalize, as those with high emotional hazard have an average foreign entry per firm of 6.34, whilst those with low emotional hazard reach a comparable value of 6.89. However, emotional hazard has a relevant effect for family leaders. Indeed, when they lead the former, they have a positive effect (coef. = 0.369; p-value = 0.011) on WOS preference, whilst it is negative (coef. = -0.282; p-value = 0.020) when they lead the latter. In terms of average marginal effect, the presence of a family leader increases the probability of undertaking a WOS by 10.2 percent in family firms with high emotional hazard; such a probability it reduced by 8.6 percent when they lead firms with low emotional hazard (models (2) and (4) in Table 7).

*[Insert Table 6 about here]*

*[Insert Table 7 about here]*

We find a confirmation of the preceding findings in Table 8. We have seen that the two hazards help explaining the choice between WOS and JV. In particular, both low performance hazard and high emotional hazard push towards WOSs, while both high performance hazard and low emotional hazard lead to choose JVs. When we combine the two hazards, we find that such effects strengthen or compensate each other. Family leaders have a strong and significant effect, with regard to WOS probability, in firms in low performance hazard and high emotional hazard (coef. = 0.410; p-value = 0.002), as reported in model (1) in Table 8. The effect of family leadership in terms of WOS probability is equal to a rise of 9.1 percent (model (1) in Table 9). The opposite is true for firms with high performance hazard and low emotional hazard (model (4) in Table 8). Namely, family leadership has a strong and negative effect for such firms (coef. = -0.542; p-value < 0.001). This leads to a reduction of the likelihood of choosing WOS of 15.8 percent. Models (2) and (3) of Table 8 show that, when firms have one hazard that push towards WOS and the other towards JV, the impact of the family leader is negligible and not significant. However, although they do not have enough statistical power, we simply note that the sign of the relationship always follows the emotional hazard driver, i.e., it is negative when emotional hazard is low, as in model (2), and it is positive when emotional hazard is high, as in model (3). Thus, hypothesis 2 is supported.

Finally, we investigate the role of cultural distance. In models (5) to (9) of Table 8, we insert the cultural distance and its interaction with family leader. We note that cultural distance has always a positive sign in all the models, meaning that when cultural distance is high, firms in the sample more likely prefer to enter the country with a WOS. The average marginal effects in Table 9 tell us that a one standard deviation increase (decrease) in cultural distance augments (reduces) the WOS probability between 3.9 and 12.8 percent. Moving to the interaction effect, we find support for H3. Specifically, we have argued that cultural distance affects firms with high emotional hazard by reducing their proclivity towards WOS – i.e., reducing the need to have the entire control of the subsidiary –, while it should have a negligible effect on firms with low emotional hazard. Accordingly, the estimates show that when emotional hazard is high, models (5) and (7) of Table 8,

the coefficients of the interaction terms are negative and significant. Namely, it is equal to -0.237 (p-value = 0.047) when the firm has also low performance hazard and it is -0.338 (p-value = 0.027) when the firm has high performance hazard. Average marginal effects are equal to -5.3 and -11.7 percent, respectively. On the other hand, when emotional hazard is low, coefficients have a smaller magnitude – in model (8), it is even slightly positive – and they are not significant. Consequently, average marginal effects are negligible – below 2 percent in absolute terms – and never significant.

*[Insert Table 8 about here]*

*[Insert Table 9 about here]*

## **DISCUSSION AND CONCLUSIONS**

In the purpose to dig into SEW's theoretical foundations and antecedents of actual decision-makers behaviors, our findings help to better understand logics underling family leaders' strategic decision-making in front of a particularly relevant decision during the internationalization process: the subsidiary ownership policy. Specifically, we challenge the universalistic assumption that SEW preservation is a vaguely emotional decision-making criterion for family leaders (Berrone et al., 2010; Gomez-Mejia et al., 2007, 2011) by taking into consideration how the family leaders' aversion to lose family control varies depends on certain circumstances. In doing so, we argue that both performance hazard and emotional hazard might influence the emphasis family leaders place on SEW preservation and consequently how strong their family control loss aversion is in strategic decision-making. Additionally, by considering the role of cultural distance between the domestic and the host country, which is particularly relevant for subsidiary ownership policies, we isolate a specific foreign context-related issue that may weaken – as the cultural distance increases – the family leader's emotional decision-making driver.

More in details, we first show that when the family firms is suffering low performance (i.e., exposed to high performance hazard), the family leader is less focused on avoiding family control losses, preferring foreign investments shared with an external partner (namely, joint ventures). This

strategic approach switches to the opposite when the family leader operates in a well-performing firm (i.e., exposed to low performance hazard): consistent with our hypotheses, we found that family leaders are more likely to establish a subsidiary entirely controlled by the family business abroad. Second, we point out that the above tendency can be moderated by the level of emotional hazard. Our findings show that family leaders have a stronger positive relation with WOSs when low level of performance hazard couples with high levels of emotional hazard, i.e., when there is a strong family identity due to identical family and company names (Zellweger et al., 2010, 2013). Conversely, family leaders have a stronger negative relation with WOSs (thus more prone to choose JVs) when high level of performance hazard couples with less emotional hazard. That supports the idea that family leader's strategic behavior is driven by emotional ingredient only *when* economic conditions of the firm permit so. As such, *our study provides a less "emotional" interpretation of SEW, showing that the choice to give priority to emotions is deliberate, situational, and pertained to those family exhibiting high level of family identity.*

Additionally, we investigate the moderating role of cultural distance, suggesting that moving from the domestic to the foreign context the SEW preservation goal might be subjected to change. Our results are in line with the recent distinction between restricted and extended SEW (Miller and Le Breton-Miller, 2014) which depicts two types of non-economic utilities stemming from family control: the *affective* category includes family-focused priorities whereas the *social* category encompasses benefits related to the firm's social status in the local community and positive relationships with all its stakeholder. We argue that higher cultural distance is associated with lower emphasis on the *social* dimension of SEW with a consequent reduction of the overall importance of SEW preservation goal. Our point is the following: a family leader is highly embedded in the domestic context and for this reason would perceive a loss of family control as a loss of social legitimacy and reputation due to a strong role of the *social* dimension of SEW in addition to the *affective* one (Berrone et al., 2010; Miller and Le Breton-Miller, 2014); that is not supposed to happen moving to a culturally distant country where relationships with local stakeholders are not perceived as a source of SEW. In line with our argument, our results indicate that family leaders modify the strategic behavior when

the foreign country is distant – under a cultural point of view – from the domestic country. In this context, we found family leaders more likely to choose JVs and therefore more willing to dilute family control and treating SEW preservation: this result is robust even under high emotional hazard and regardless the level of performance hazard (Figure 1). In culturally distant countries, the family leader is less focused on noneconomic goals and family control loss aversion is no longer the primary reference point for strategic decision-making.

*[Insert Figure 1 about here]*

### **Contributions for theory and literature**

Our results allow us to make a step forward in disentangling and testing the roots of behavioral theories, and particularly SEW – given the specific focus on family firms. Building on insights from prospect theory (Kahneman and Tversky, 1979), indeed, proponents of the behavioral agency model, or BAM (Wiseman and Gomez Mejia, 1998), elaborated on the idea that decision-makers' risk preferences will be highly dependent on the positive or negative framing of problems, influencing decisions through the positive prospects (gain mode) or negative ones (loss mode) that characterize the context of decision-making processes. With respect to this, we theoretically and empirically confirm and expand the notion that risk evaluation is subjective and contextual, rather than being solely based on economic evaluations that consider risks against financial returns. Nevertheless, while context-based risk assessment might be extended also to managerial decisions, regardless the ownership structure of the firm (March and Shapira, 1987, 1992), what our study uniquely shows is the role of the emotional decision-making driver inside family firms. We observe how the emotional hazard – stemming from family identity – can strengthen or weaken the loss aversion of family leaders operating under different levels of performance hazard. In doing so we indicate that whether the family firm is exposed to high emotional hazard or not, the SEW preservation goal plays an either higher or lower role in driving the family leader strategic decisions in foreign markets. Furthermore, this relation is challenged by the role of cultural distance, such that the higher the cultural distance

the weaker the role of the emotional driver in family leader's strategic decisions. Hence, the family leader's aversion to lose family control – and the related SEW preservation goal – varies not only depending on the level of performance and emotional hazard under which the leader operates, but also based on the foreign cultural context wherein the family control has to be maintained.

In this way, we provide one of the first explanations for ambiguous interpretations of SEW. On the one hand, we challenge the widely acknowledged opinion that family firms are willing to jeopardize financial performance in order to protect their SEW; at the same time, we expand the idea that the decision-making reference point for family leaders drastically switches when there is a severe performance hazard (Gomez-Mejia et al., 2007, 2011). On the other hand, we point out that previous studies overlooked the contrasting forces characterizing different circumstances surrounding family leader's strategic decisions. As such, more investigation on the situational nature of SEW is definitely wanted.

Our findings have other implications for family business and international business literatures. First, we add to the SEW growing literature on family firms by investigating family leaders' strategic decisions related to foreign markets entry. Despite the wide amount of contributions on the role of SEW in driving strategic decision-making in family firms (e.g. Berrone et al., 2010; Gomez-Mejia, Makri and Larraza-Kintana, 2010; Leitterstorf and Rau, 2014; Patel and Chrisman, 2014; Strike et al., 2015), internationalization strategies have been overlooked insofar. In addition, our work makes a step forward in family business literature about internationalization by highlighting how family firms go international. Studies developed on this topic mainly focused on the degree and scope of internationalization with conflicting and inconclusive evidence (for a review see Pukall and Calabrò, 2014). We suggest that by centering the attention on strategic decisions related to foreign market entry modes it is possible to shed the light on the distinctiveness of family firms behavior overseas. Our study provides contributions also to the international business literature. On the one hand, we introduce an often neglected, but potentially very relevant variable in explaining heterogeneity in internationalization's choices, that is the corporate ownership structure. On the other hand, we add to the debate about cultural distance as an antecedent of entry modes and specifically the subsidiary

ownership policies. Despite the amount of available contributions, literature is contradictory on this topic: several studies found that cultural distance enhances the propensity to choose JVs (e.g. Hennart and Larimo, 1998; Pak and Park, 2004); others found instead that it enhances the propensity to choose WOSs (e.g. Anand and Delios, 1997; Padmanabhan and Cho, 1996); still others showed mixed or non-significant findings (e.g. Chang and Rosenzweig, 2001; Luo, 2001). Our study points out that cultural distance is important to reinforce or weaken family leaders' preference for WOSs due to its potential to affect the emphasis family control preservation.

### **Implications for practice and limitations**

Our findings shed the light on the emotional ingredient of family leader's strategic decision-making which arise from the overlapping between the family and the business and it is particularly visible in family firms which carry the family name. Although it is still controversial the extent to which it could be an advantage or rather a disadvantage, we argue that family owners should meditate on this issue. Moreover, our study may help to understand family firms' strategic behavior overseas: it could suggest family owners to rely on external managers to mitigate that emotional ingredient when certain circumstances – that our study pinpoints – characterize the company.

This study is not free from limitations. Theoretically, we posit that the level of emotional hazard rely on the intensity of family identity. Whereas it is easy to agree that stronger family identity exposes family principals to higher emotional hazard, it is also true that the family identity may not be the only source of this type of hazard. At the same time, our work is one of the first attempts to test single contexts wherein the SEW preservation leads family leaders decisions and future research should focus in this direction. Second, we do not investigate whether the SEW preservation has a direct effect on the subsidiary performances. This is an empirical issue, as the vast majority of subsidiaries do not report their financial data separately from the parent firm, thus making hard detecting which is their performance after the foreign entry. Third and importantly, we consider family leadership as exogenous to the subsidiary ownership policy in line with previous studies on

the topic (e.g. Brouthers and Hennart, 2007; Brouthers, Brouthers and Werner, 2003) also when considering other governance explanatory variable (Filatotchev et al., 2007). The structure of the analyses do not allow us to test whether endogeneity issues arises in the study. Finally, despite we underpin the theory with arguments that relate to family firms in general, data come from Italian family firms. However similarly to prior studies that relied on one-country data to investigate SEW logics in family business (e.g. Gomez-Mejia et al., 2007), we argue that our findings might be generalizable also for family firms in other countries.

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## LIST OF TABLES AND FIGURES

**Table 1. Foreign entries statistics and geographic distribution.**

Country	Non-family led		Family led		Total	
	No.	%	No.	%	No.	%
China	283	18.42	509	21.18	792	20.11
United States	348	22.66	387	16.10	735	18.66
Germany	129	8.40	312	12.98	441	11.20
Spain	134	8.72	224	9.32	358	9.09
Brazil	96	6.25	120	4.99	216	5.48
Poland	53	3.45	95	3.95	148	3.76
Romania	37	2.41	111	4.62	148	3.76
India	51	3.32	85	3.54	136	3.45
Russia	42	2.73	73	3.04	115	2.92
Mexico	44	2.86	66	2.75	110	2.79
Argentina	41	2.67	59	2.46	100	2.54
Canada	51	3.32	46	1.91	97	2.46
Turkey	43	2.80	46	1.91	89	2.26
Australia	33	2.15	28	1.17	61	1.55
South Africa	15	0.98	44	1.83	59	1.50
Japan	24	1.56	30	1.25	54	1.37
Sweden	23	1.50	30	1.25	53	1.35
Bulgaria	11	0.72	24	1.00	35	0.89
Egypt	13	0.85	21	0.87	34	0.86
Morocco	11	0.72	21	0.87	32	0.81
Chile	18	1.17	13	0.54	31	0.79
Ukraine	8	0.52	22	0.92	30	0.76
South Korea	8	0.52	11	0.46	19	0.48
Finland	6	0.39	11	0.46	17	0.43
Norway	8	0.52	6	0.25	14	0.36
Indonesia	5	0.33	8	0.33	13	0.33
Jordan	1	0.07	1	0.04	2	0.05
Total foreign entries	1,536	39.00	2,403	61.00	3,939	100.00
Number of firms	125	21.33	461	78.67	586	100.00
Average foreign entry per firm	12.29		5.21		6.72	

Note:

Percentages in rows “Total foreign entries” and “Number of firms” are computed with reference to the “Total” column

**Table 2. Descriptive statistics.**

#	Variable	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)	VIF
(1)	Wholly-owned subsidiary															
(2)	Family leader	-0.063														1.341
(3)	Cultural distance	0.063	0.011													1.208
(4)	Parent age	0.073	-0.180	-0.067												2.264
(5)	Parent size	0.109	-0.362	-0.025	0.575											2.064
(6)	Leverage	-0.020	-0.115	-0.013	0.049	0.144										1.083
(7)	R&D intensity	0.083	-0.290	-0.011	0.456	0.506	0.158									1.597
(8)	Family ownership	-0.112	0.359	-0.009	-0.430	-0.564	-0.057	-0.488								1.737
(9)	First generation	0.025	0.031	0.034	-0.536	-0.175	-0.039	-0.190	0.137							1.475
(10)	Female leader	-0.018	0.183	-0.006	-0.129	-0.118	0.127	-0.101	0.170	0.116						1.111
(11)	Tenure leader	-0.049	0.285	0.025	-0.094	-0.174	-0.130	-0.047	0.226	-0.014	-0.081					1.169
(12)	Country risk	-0.016	-0.046	0.090	0.012	-0.026	0.031	-0.012	0.019	-0.017	0.026	-0.005				1.021
(13)	Administrative distance	-0.002	0.012	0.049	-0.026	-0.034	-0.019	-0.043	0.057	-0.011	0.025	0.016	0.048			1.011
(14)	Geographic distance	-0.018	-0.085	0.398	-0.020	0.041	0.004	0.078	-0.025	0.004	0.014	0.019	0.080	-0.012		1.227
	Mean	0.747	0.610	-0.003	43.839	7.641	3.884	0.009	0.771	0.463	0.058	12.056	5.041	-0.003	6.086	1.407
	Standard deviation	0.435	0.488	0.983	33.306	2.343	3.642	0.020	0.256	0.499	0.234	8.411	3.013	0.992	3.761	
	Minimum	0	0	-1.148	0	0.693	0	0	0	0	0	0	0	-1.063	0.954	
	Maximum	1	1	2.417	147	12.231	9.640	0.070	1	1	1	49	7	11.360	14.425	

Note:

Correlations of |0.031| or higher are significant at  $p < 0.05$

Correlations of |0.041| or higher are significant at  $p < 0.01$

**Table 3. Panel A. Wholly-owned subsidiary propensity for family led firms.**

		High EH (%)	Low EH (%)	Difference (%)
		77.50	69.86	7.64***
Low PH (%)	78.49	84.24	74.02	10.22***
High PH (%)	67.60	68.90	67.09	1.81
Difference (%)	10.89***	15.34***	6.93*	

**Table 3. Panel B. Wholly-owned subsidiary propensity for non-family led firms.**

		High EH (%)	Low EH (%)	Difference (%)
		71.32	79.50	8.18**
Low PH (%)	76.50	66.10	78.39	12.29*
High PH (%)	78.66	72.86	79.87	7.01*
Difference (%)	2.16	6.76	1.48	

Note:

PH is performance hazard

EH is emotional hazard

Differences are in absolute value

Significances refer to the two-tailed t-test

† p < 0.10, \* p < 0.05, \*\* p < 0.01, \*\*\* p < 0.001

**Table 4. Probit models. Dependent variable: WOS. Sample: Full, Low performance hazard and High performance hazard.**

	(1)	(2)	(3)	(4)	(5)	(6)
	Full sample	Full sample	Low PH	Low PH	High PH	High PH
Family leader		-0.039 (0.096)		<b>0.426*</b> <b>(0.182)</b>		<b>-0.310*</b> <b>(0.127)</b>
Parent age	0.000 (0.002)	0.000 (0.002)	0.004 (0.003)	0.004 (0.003)	0.000 (0.002)	-0.000 (0.002)
Parent size	0.096** (0.030)	0.094** (0.030)	0.099 (0.067)	0.081 (0.067)	0.094* (0.037)	0.067† (0.035)
Leverage	-0.005 (0.009)	-0.005 (0.009)	-0.039† (0.021)	-0.036† (0.021)	0.009 (0.009)	0.011 (0.009)
R&D intensity	0.892 (2.205)	0.767 (2.171)	-2.684 (6.652)	-0.633 (6.227)	2.080 (3.038)	2.324 (2.939)
Family ownership	-0.120 (0.195)	-0.112 (0.199)	0.199 (0.396)	0.362 (0.373)	-0.043 (0.226)	0.072 (0.236)
First generation	0.174* (0.089)	0.173† (0.088)	0.236 (0.162)	0.257 (0.162)	0.133 (0.108)	0.100 (0.105)
Female leader	-0.048 (0.121)	-0.037 (0.124)	0.328 (0.275)	0.272 (0.265)	-0.111 (0.162)	0.012 (0.177)
Tenure leader	-0.006 (0.004)	-0.005 (0.005)	-0.013† (0.008)	-0.016* (0.008)	-0.001 (0.006)	0.005 (0.006)
Country risk	0.007 (0.009)	0.007 (0.009)	0.030* (0.015)	0.029† (0.015)	-0.001 (0.012)	-0.002 (0.012)
Administrative distance	0.002 (0.023)	0.002 (0.023)	-0.008 (0.032)	-0.010 (0.032)	-0.010 (0.033)	-0.016 (0.033)
Geographic distance	-0.006 (0.007)	-0.006 (0.007)	-0.014 (0.011)	-0.013 (0.011)	-0.004 (0.009)	-0.003 (0.009)
Constant	-0.391 (0.380)	-0.370 (0.389)	-0.913 (0.759)	-1.260† (0.724)	-0.164 (0.461)	0.038 (0.457)
Industry dummies	Yes	Yes	Yes	Yes	Yes	Yes
Time dummies	Yes	Yes	Yes	Yes	Yes	Yes
Observations	3,939	3,939	1,471	1,471	2,468	2,468
Firms	586	586	204	204	382	382
Ratio of correct classification	74.61%	74.71%	78.45%	78.79%	73.18%	73.91%
Pseudo R <sup>2</sup>	0.121	0.121	0.213	0.222	0.115	0.122
Likelihood ratio	335.52***	335.91***	220.29***	229.37***	204.72***	217.22***

Note:

PH is performance hazard

Firm-level clustered standard errors in parentheses

† p < 0.10, \* p < 0.05, \*\* p < 0.01, \*\*\* p < 0.001

Pseudo R<sup>2</sup> follows the Cragg & Uhler's calculation

**Table 5. Average marginal effects. Dependent variable: WOS. Sample: Full, Low performance hazard and High performance hazard.**

	(1) Full sample	(2) Full sample	(3) Low PH	(4) Low PH	(5) High PH	(6) High PH
Family leader		-0.011 (0.028)		<b>0.107*</b> <b>(0.046)</b>		<b>-0.095*</b> <b>(0.039)</b>
Parent age	0.000 (0.001)	0.000 (0.001)	0.001 (0.001)	0.001 (0.001)	0.000 (0.001)	0.000 (0.001)
Parent size	0.028** (0.009)	0.028** (0.009)	0.025 (0.017)	0.020 (0.017)	0.029** (0.011)	0.021† (0.011)
Leverage	-0.002 (0.003)	-0.002 (0.003)	-0.010† (0.005)	-0.009† (0.005)	0.003 (0.003)	0.003 (0.003)
R&D intensity	0.263 (0.651)	0.226 (0.640)	-0.681 (1.687)	-0.159 (1.569)	0.639 (0.934)	0.711 (0.900)
Family ownership	-0.035 (0.057)	-0.033 (0.059)	0.051 (0.100)	0.091 (0.094)	-0.013 (0.069)	0.022 (0.072)
First generation	0.051† (0.026)	0.051† (0.026)	0.060 (0.041)	0.065 (0.041)	0.041 (0.033)	0.030 (0.032)
Female leader	-0.014 (0.036)	-0.011 (0.037)	0.083 (0.069)	0.069 (0.067)	-0.034 (0.050)	0.004 (0.054)
Tenure leader	-0.002 (0.001)	-0.002 (0.001)	-0.003† (0.002)	-0.004* (0.002)	-0.000 (0.002)	0.001 (0.002)
Country risk	0.002 (0.003)	0.002 (0.003)	0.008* (0.004)	0.007† (0.004)	-0.000 (0.004)	-0.001 (0.004)
Administrative distance	0.001 (0.007)	0.001 (0.007)	-0.002 (0.008)	-0.002 (0.008)	-0.003 (0.010)	-0.005 (0.010)
Geographic distance	-0.002 (0.002)	-0.002 (0.002)	-0.004 (0.003)	-0.003 (0.003)	-0.001 (0.003)	-0.001 (0.003)
Industry dummies	Yes	Yes	Yes	Yes	Yes	Yes
Time dummies	Yes	Yes	Yes	Yes	Yes	Yes
Observations	3,939	3,939	1,471	1,471	2,468	2,468

Note:

PH is performance hazard

Robust standard errors in parentheses

† p < 0.10, \* p < 0.05, \*\* p < 0.01, \*\*\* p < 0.001

**Table 6. Probit models. Dependent variable: WOS. Coefficients and average marginal effects. Sample: High emotional hazard and Low emotional hazard.**

	(1) High EH	(2) High EH	(3) Low EH	(4) Low EH
Family leader		<b>0.369*</b> <b>(0.146)</b>		<b>-0.282*</b> <b>(0.121)</b>
Parent age	0.004 (0.004)	0.006 (0.004)	0.002 (0.002)	0.002 (0.002)
Parent size	0.182** (0.057)	0.188*** (0.056)	0.039*** (0.111)	0.050*** (0.012)
Leverage	0.027 (0.021)	0.029 (0.021)	-0.007 (0.008)	-0.009 (0.008)
R&D intensity	3.733 (7.621)	2.142 (7.785)	2.787 (2.767)	1.527 (2.359)
Family ownership	-0.415 (0.617)	-0.340 (0.568)	-0.418† (0.220)	-0.330 (0.230)
First generation	0.317† (0.182)	0.340† (0.177)	0.156 (0.111)	0.145 (0.106)
Female leader	0.021 (0.207)	-0.113 (0.210)	-0.039 (0.129)	0.027 (0.135)
Tenure leader	-0.004 (0.006)	-0.009 (0.007)	-0.001 (0.006)	0.004 (0.006)
Country risk	-0.009 (0.017)	-0.009 (0.017)	0.000 (0.011)	-0.000 (0.011)
Administrative distance	-0.057 (0.040)	-0.051 (0.040)	0.010 (0.027)	0.009 (0.027)
Geographic distance	0.013 (0.014)	0.015 (0.014)	0.011 (0.008)	0.010 (0.008)
Constant	-1.123 (0.814)	-1.589* (0.807)	0.448 (0.307)	0.551† (0.301)
Industry dummies	Yes	Yes	Yes	Yes
Time dummies	Yes	Yes	Yes	Yes
Observations	1,107	1,107	2,832	2,832
Firms	175	175	411	411
Ratio of correct classification	75.69%	75.69%	74.59%	74.59%
Pseudo R <sup>2</sup>	0.163	0.177	0.083	0.092
Likelihood ratio	126.16***	137.43***	165.08***	183.51***

Note:

EH is emotional hazard

AME is average marginal effects

Firm-level clustered standard errors in parentheses

† p < 0.10, \* p < 0.05, \*\* p < 0.01, \*\*\* p < 0.001

Pseudo R<sup>2</sup> follows the Cragg & Uhler's calculation

**Table 7. Average marginal effects. Dependent variable: WOS. Sample: High emotional hazard and Low emotional hazard.**

	(1) High EH	(2) High EH	(3) Low EH	(4) Low EH
Family leader		<b>0.102**</b> <b>(0.038)</b>		<b>-0.086*</b> <b>(0.036)</b>
Parent age	0.001 (0.001)	0.002 (0.001)	0.001 (0.001)	0.001 (0.001)
Parent size	0.051*** (0.015)	0.052*** (0.015)	0.000*** (0.000)	0.000*** (0.000)
Leverage	0.008 (0.006)	0.008 (0.006)	-0.002 (0.002)	-0.003 (0.002)
R&D intensity	1.039 (2.132)	0.590 (2.150)	0.852 (0.850)	0.464 (0.721)
Family ownership	-0.116 (0.167)	-0.094 (0.154)	-0.128† (0.066)	-0.100 (0.069)
First generation	0.088† (0.049)	0.094† (0.048)	0.048 (0.034)	0.044 (0.032)
Female leader	0.006 (0.058)	-0.031 (0.057)	-0.012 (0.039)	0.008 (0.041)
Tenure leader	-0.001 (0.002)	-0.002 (0.002)	-0.000 (0.002)	0.001 (0.002)
Country risk	-0.003 (0.005)	-0.002 (0.005)	0.000 (0.003)	-0.000 (0.003)
Administrative distance	-0.016 (0.011)	-0.014 (0.011)	0.003 (0.008)	0.003 (0.008)
Geographic distance	0.004 (0.004)	0.004 (0.004)	0.003 (0.002)	0.003 (0.002)
Industry dummies	Yes	Yes	Yes	Yes
Time dummies	Yes	Yes	Yes	Yes
Observations	1,107	1,107	2,832	2,832

Note:

EH is emotional hazard

Robust standard errors in parentheses

† p < 0.10, \* p < 0.05, \*\* p < 0.01, \*\*\* p < 0.001

**Table 8. Probit models. Dependent variable: WOS. Sample: Combinations of performance hazard and emotional hazard.**

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
	Low PH & High EH	Low PH & Low EH	High PH & High EH	High PH & Low EH	Low PH & High EH	Low PH & Low EH	High PH & High EH	High PH & Low EH
Family leader	<b>0.410**</b> <b>(0.134)</b>	-0.039 (0.251)	0.076 (0.442)	<b>-0.542***</b> <b>(0.151)</b>	<b>0.369**</b> <b>(0.140)</b>	-0.050 (0.250)	0.056 (0.434)	<b>-0.534***</b> <b>(0.149)</b>
Cultural distance					0.291** (0.098)	0.145† (0.086)	0.424** (0.150)	0.142** (0.051)
Family leader x Cultural distance					<b>-0.237*</b> <b>(0.119)</b>	-0.055 (0.103)	<b>-0.388*</b> <b>(0.175)</b>	0.052 (0.069)
Parent age	0.002 (0.004)	0.007† (0.004)	0.011 (0.013)	0.001 (0.003)	0.002 (0.004)	0.007† (0.004)	0.012 (0.013)	0.001 (0.003)
Parent size	0.271*** (0.072)	0.085 (0.077)	0.229 (0.199)	0.026 (0.038)	0.283*** (0.074)	0.081 (0.076)	0.220 (0.198)	0.028 (0.039)
Leverage	0.070 (0.050)	-0.052* (0.024)	0.026 (0.044)	0.012 (0.010)	0.073 (0.053)	-0.050* (0.023)	0.021 (0.043)	0.013 (0.010)
R&D intensity	12.021 (13.328)	-4.125 (8.413)	12.476 (23.168)	3.001 (3.389)	12.884 (13.213)	-3.653 (8.500)	13.786 (23.068)	3.233 (3.240)
Family ownership	-0.130 (0.419)	0.095 (0.493)	0.361 (1.123)	0.411† (0.241)	-0.089 (0.426)	0.179 (0.496)	0.350 (1.109)	0.430† (0.245)
First generation	0.373† (0.200)	0.406† (0.212)	0.105 (0.565)	0.112 (0.126)	0.368† (0.202)	0.416† (0.213)	0.131 (0.550)	0.108 (0.127)
Female leader	-0.329 (0.273)	0.329 (0.476)	-0.635 (0.498)	-0.089 (0.193)	-0.311 (0.280)	0.378 (0.477)	-0.639 (0.500)	-0.125 (0.190)
Tenure leader	-0.023** (0.008)	-0.010 (0.011)	-0.000 (0.024)	0.001 (0.007)	-0.024** (0.008)	-0.011 (0.011)	-0.002 (0.023)	0.002 (0.007)
Country risk	-0.005 (0.023)	0.033† (0.019)	0.005 (0.026)	0.004 (0.014)	-0.008 (0.023)	0.029 (0.019)	0.004 (0.026)	-0.000 (0.015)
Administrative distance	0.008 (0.049)	-0.020 (0.037)	-0.075 (0.133)	-0.009 (0.038)	0.007 (0.049)	-0.022 (0.036)	-0.060 (0.131)	-0.020 (0.038)
Geographic distance	-0.010 (0.017)	-0.013 (0.014)	-0.018 (0.022)	-0.004 (0.011)	-0.022 (0.018)	-0.023 (0.015)	-0.026 (0.022)	-0.022† (0.012)
Constant	-1.362† (0.696)	-0.495 (0.872)	-2.255 (1.890)	-0.113 (0.490)	-1.349† (0.702)	-0.529 (0.873)	-2.111 (1.869)	-0.101 (0.501)
Industry dummies	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Time dummies	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Observations	535	936	572	1,896	535	936	572	1,896
Firms	56	148	119	263	56	148	119	263
Ratio of correct classification	81.44%	76.71%	72.79%	75.16%	81.05%	76.60%	73.47%	75.05%
Pseudo R <sup>2</sup>	0.305	0.206	0.228	0.166	0.312	0.212	0.250	0.179
Likelihood ratio	165.30***	139.65***	52.72**	228.79***	169.50***	143.59***	58.29**	248.02***

Note:

PH is performance hazard

EH is emotional hazard

Firm-level clustered standard errors in parentheses

† p < 0.10, \* p < 0.05, \*\* p < 0.01, \*\*\* p < 0.001

Pseudo R<sup>2</sup> follows the Cragg & Uhler's calculation

**Table 9. Average marginal effects. Dependent variable: WOS. Sample: Combinations of performance hazard and emotional hazard.**

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
	Low PH & High EH	Low PH & Low EH	High PH & High EH	High PH & Low EH	Low PH & High EH	Low PH & Low EH	High PH & High EH	High PH & Low EH
Family leader	<b>0.091**</b> <b>(0.030)</b>	-0.011 (0.068)	0.023 (0.136)	<b>-0.158***</b> <b>(0.044)</b>	<b>0.082**</b> <b>(0.031)</b>	-0.014 (0.068)	0.017 (0.131)	<b>-0.154***</b> <b>(0.043)</b>
Cultural distance					0.065** (0.021)	0.039 <sup>†</sup> (0.023)	0.128** (0.045)	0.041** (0.015)
Family leader x Cultural distance					<b>-0.053*</b> <b>(0.026)</b>	-0.015 (0.028)	<b>-0.117*</b> <b>(0.053)</b>	0.015 (0.020)
Parent age	0.000 (0.001)	0.002 (0.001)	0.004 (0.004)	0.000 (0.001)	0.000 (0.001)	0.002 <sup>†</sup> (0.001)	0.004 (0.004)	0.000 (0.001)
Parent size	0.061*** (0.015)	0.023 (0.021)	0.071 (0.061)	0.008 (0.011)	0.063*** (0.016)	0.022 (0.020)	0.067 (0.060)	0.008 (0.011)
Leverage	0.016 (0.011)	-0.014* (0.006)	0.008 (0.013)	0.004 (0.003)	0.016 (0.012)	-0.013* (0.006)	0.006 (0.013)	0.004 (0.003)
R&D intensity	4.912 <sup>†</sup> (2.936)	-1.119 (2.278)	3.847 (7.145)	0.876 (0.990)	5.073 <sup>†</sup> (2.894)	-0.987 (2.292)	4.175 (6.984)	0.934 (0.937)
Family ownership	-0.029 (0.094)	0.026 (0.134)	0.111 (0.345)	0.120 <sup>†</sup> (0.070)	-0.020 (0.095)	0.048 (0.134)	0.106 (0.335)	0.124 <sup>†</sup> (0.070)
First generation	0.083 <sup>†</sup> (0.044)	0.110 <sup>†</sup> (0.058)	0.032 (0.174)	0.033 (0.037)	0.081 <sup>†</sup> (0.044)	0.112 <sup>†</sup> (0.058)	0.040 (0.166)	0.031 (0.037)
Female leader	-0.073 (0.060)	0.089 (0.129)	-0.196 (0.153)	-0.026 (0.056)	-0.069 (0.061)	0.102 (0.128)	-0.193 (0.151)	-0.036 (0.055)
Tenure leader	-0.005** (0.002)	-0.003 (0.003)	-0.000 (0.007)	0.000 (0.002)	-0.005** (0.002)	-0.003 (0.003)	-0.001 (0.007)	0.001 (0.002)
Country risk	-0.001 (0.005)	0.009 <sup>†</sup> (0.005)	0.002 (0.008)	0.001 (0.004)	-0.002 (0.005)	0.008 (0.005)	0.001 (0.008)	-0.000 (0.004)
Administrative distance	0.002 (0.011)	-0.005 (0.010)	-0.023 (0.041)	-0.003 (0.011)	0.002 (0.011)	-0.006 (0.010)	-0.018 (0.040)	-0.006 (0.011)
Geographic distance	-0.002 (0.004)	-0.004 (0.004)	-0.006 (0.007)	-0.001 (0.003)	-0.005 (0.004)	-0.006 (0.004)	-0.008 (0.007)	-0.006 <sup>†</sup> (0.004)
Industry dummies	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Time dummies	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Observations	535	936	572	1,896	535	936	572	1,896

Note:

PH is performance hazard

EH is emotional hazard

Robust standard errors in parentheses

<sup>†</sup> p < 0.10, \* p < 0.05, \*\* p < 0.01, \*\*\* p < 0.001

**Figure 1. Results of the analyses**

	High performance hazard	Low performance hazard
High emotional hazard	n.s. (High cultural distance: <b>JV</b> )	<b>WOS</b> (High cultural distance: <b>JV</b> )
Low emotional hazard	<b>JV</b> (High cultural distance: n.s.)	n.s. (High cultural distance: n.s.)