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Information or influence?
The benefits of experience for managing political uncertainty

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Abstract

We examine the extent to which two sources of uncertainty over the future policy environment – political hazards and regime change – influence foreign-owned subsidiary exit rates. We find that prior exits by peer firms enhance exit rates, particularly when political hazards are high. We also find that a multinational firm's own experience under the current political regime has a moderating influence on subsidiary exit rates in the presence of political hazards, but it enhances exit rates after a change in the political regime. These findings support the argument that in contrast to the informational benefit conferred by prior peer firms' exits, own firm experience proxies for actual or perceived influence in a nation's policy-making process.

Key words • environmental uncertainty • experience • multinational • political risk • survival

A widely held view in the organizations literature is that a firm's accumulation of experience in a new market reduces its exposure to the potentially adverse effects of uncertainty in that market (Barkema et al., 1996; Delios and Henisz, 2003; Henisz and Delios, 2001; Pennings et al., 1994). Such experience can aid a multinational firm to overcome its liability of foreignness in the various countries in which it operates (Barkema and Vermeulen, 1998; Zaheer, 1995; Zaheer and Mosakowski, 1997).

Earlier work on the causal mechanisms by which experience conveys performance benefits to multinational firms facing environmental uncertainty presents two seemingly complementary theoretical rationales. The first rationale hinges on the idea that a firm's own experience is an important source of information on a host country's environment. Firms with more information from this or other sources (e.g. due diligence, allied firms or peer firms) make better forecasts of the future political environment and adapt accordingly to improve performance. The second rationale builds on the idea that firms with more experience in a country become more embedded. Experienced firms are more

likely to be able to devise strategies that influence that environment or they may be perceived by other actors to possess such influence. In either case, the performance of experienced firms is tied to the stability of the current environment.

Often this conceptual division between information- and influence-based arguments about the benefits of experience is analytically intractable. But an empirical analysis that identifies the relative merits of the two processes is important in order to inform underlying theories about the benefits of experience, and in order to help one conceptualize experience-based strategies. Further, in the context of the political environment, identifying whether an influence or information rationale prevails can help managers develop non-market strategies (those strategies designed to enhance firms' performance by directly or indirectly influencing political actors in their choice of policy) (Baron, 1995a, 1995b; Henisz and Zelner, 2003).

We distinguish between these two theoretical arguments by examining the performance of multinational subsidiaries in the face of two distinct challenges that emanate from the political environment of a host country. The first challenge consists of political hazards which stem from the structure of a country's existing political institutions, which either provide substantial or limited discretion to policy-makers. When policy-makers' discretion is high, managers face a greater likelihood that the status-quo policies that affect their costs, revenues and asset values will change. But if political institutions constrain policy-makers through checks and balances, there is a greater probability that policies will persist. The second challenge is regime change, which involves the replacement of an existing set of political institutions with an entirely new structure. Managers seeking to forecast or influence the future policy environment during a regime change must simultaneously struggle with new policy-makers, new rules and new interest groups, as opposed to continuing to work within an existing set of political institutions.

We argue that if experience generates useful information to a firm about the political environment, it should be of positive value in the presence of both political hazards and regime change. If experience leads to the development of actual or perceived influence over the political environment, in the event of a regime change there may be a rapid depreciation in the benefits of this influence. At the extreme, experience may even shift from being an asset to becoming a liability. To empirically test whether the benefits of experience in the context of uncertainty emanating from the political environment relate to information or influence, we look at the choice of whether to keep or terminate existing subsidiaries in host countries that differ in their levels of political hazards and incidence of regime change.

Our empirical models examine influences on the exit rates of 2283 affiliates of 642 Japanese manufacturing firms in 52 countries. Consistent with earlier research, we find that prior peer exits are associated with higher exit rates, particularly in the subsample of countries with great political hazards. Turning to own firm experience and the possible interpretations thereof, we find that

experienced firms have lower exit rates in countries with high levels of political hazards as predicted by both the informational and influence rationales. Experience, however, transforms into a significant liability in the year of a regime change, suggesting that experience contributes to actual or perceived influence that is specific to the regime in which it was garnered.

Background

Environmental uncertainty

Environmental uncertainty is among the foremost challenges with which an organization's management must contend (Thompson, 1967). A core tenet emerging from research in this area is that organizations seek to avoid uncertainty (Cyert and March, 1963). Early studies on organizations made extensive use of the aggregate construct of environmental uncertainty (Downey and Slocum, 1975). This research pointed to the idea that organizations differ in their reactions and susceptibility to environmental uncertainty (DiMaggio and Powell, 1983; Levitt and March, 1988). Organizational variance in susceptibility to uncertainty stems from heterogeneous organizational information (Haunschild, 1994; Haunschild and Miner, 1997) and heterogeneous organizational resources or capabilities (Miner et al., 1990).

Aside from considerations of organizational heterogeneity, there is the possibility that uncertainty itself can be heterogeneous. This idea is not particularly novel, as there is a long tradition in organization theory research that has distinguished among types of uncertainty (Boyd et al., 1993; Dess and Beard, 1984; Milliken, 1987), to identify several definitional characteristics of perceived uncertainty (Boyd et al., 1993). Uncertainty concerns the lack of information in an environment given a specific decision-making scenario. This lack of information translates into difficulties in accurately assessing the losses or gains associated with correct or incorrect decisions (Duncan, 1972). Uncertainty also concerns rates and unpredictability of change in an environment (Dess and Beard, 1984). As the results of dynamic change are hard to predict, it heightens uncertainty for decision-makers.

These characterizations highlight two relevant points for differentiating among types of uncertainty. First, uncertainty can emerge from a lack of information about a particular environment. Second, uncertainty can arise from a change in that environment. By exploiting the presence of these two broad types of environmental uncertainty in the specific context of the political environment, we can explore the relative strengths of the information-based and influence-based rationales for the beneficial effect of experience.

Two political sources of environmental uncertainty in host countries

The international environment is a setting with copious sources of uncertainty. Scholars have long recognized that cultural, economic, legal, social and political

variance across countries injects substantial amounts of uncertainty into a firm's decisions about international expansions (Barkema et al., 1996; Eriksson et al., 1997; Henisz, 2000b). International expansion is a form of growth in which a firm undertakes foreign direct investment (FDI) to form a subsidiary in a country other than the one in which it is domiciled.

When expanding internationally, a firm's management often must contend with a new culture, a new language, a new social system, new market structures and a new political environment. A firm's management should understand the current and future policies that define the rules and regulations for a firm's operations – for example taxes or quantitative restrictions on production, foreign trade and employment, regulations concerning employee hiring and firing, benefits, health and safety and the local or national environment – and thereby influence its profitability.

The status-quo policies and the future policy environment are the outcome of a policy-making process in which various interest groups seek to lobby or influence policy-makers, who interact in formal and informal policy-making structures. The level of uncertainty over future policies is therefore a function of both the current policy-making structure (i.e. the extent to which it provides checks and balances against the discretion of existing policy-makers) and any fundamental changes to that structure.

Where political institutions lack checks and balances, such as among the executive, legislative, judicial and sub-federal branches, policy-makers are relatively unconstrained in their choice of policies by other actors (Henisz, 2000a; North, 1990). Such countries are characterized as politically hazardous. Countries with extensive checks and balances in the formal policy-making apparatus (low political hazards), such as the United States, Germany and Switzerland, tend to have the lowest levels of policy uncertainty as the multiple veto players involved in the policy-making process find it difficult to agree to change the status-quo policy. Political hazards increase as the number of veto players declines or as their preferences become more homogeneous, such as is the case in moving to a mixed parliamentary-presidential system, as typified by France or Brazil, to heavily fractionalized parliamentary systems like Belgium, Israel or the Netherlands, to Westminster parliamentary districts with winner-take-all districts like the UK. Transitional and non-democratic states have the highest levels of political hazards as the formal institutional structure in these countries provides tremendous discretion to policy-makers.

A second source of policy uncertainty is the emergence of a new political regime (Feng, 2001; Kobrin, 1979). When disaffected interest groups successfully militate for fundamental political reform, the very rules by which policies are made are in flux. The identity of the future political leadership, the process of policy-making and the interest groups allotted voice or excluded from the political process are each uncertain. Any one of these changes would increase the level of policy uncertainty and simultaneous changes in all would have an even greater effect. Examples of regime change include a military coup that

replaces an autocratic or a democratic regime, a transition from autocratic to democratic rule and the evolution of a democracy from a single-party to a multi-party system. Instances of regime change in the 1991–2000 period include the inception of democracy in Russia in 1991; the military coup in Thailand in 1992; the end of the apartheid government in South Africa in 1995; and the transfer of sovereignty of Hong Kong from the UK to China in 1997.

Information, influence and policy uncertainty

Given that increases in policy uncertainty generate corresponding increases in the variance of a subsidiary's expected profitability, effective strategies for reacting to it can generate substantial value for a firm, while ineffective strategies can harm a firm's performance. Accordingly, firms seek to identify a country's level of policy uncertainty before investing, and will only enter a country when the expected returns justify their additional variance. One would not therefore expect the level of policy uncertainty at the time of entry to have an independent effect on a firm's performance in that country. The effectiveness of a firm's strategy and its performance, however, may vary according to changes in the level of political hazards, the incidence of regime change or heterogeneity in the information possessed or influence strategies used to identify and moderate the effect of the uncertainties.

A basic strategy to moderate future policy uncertainty is for a firm to gather information on the likely evolution or impact of the policy environment on its operations that improves forecasts about the adoption of policies that, at the firm's expense, serve the interests of political actors, the broader polity and a firm's buyers, suppliers or competitors (Henisz and Zelner, 2005). With better information about the policy-making process, a firm can adapt its strategy accordingly by altering sourcing, pricing, marketing or other market strategies, or, at the extreme, by leaving the host country.

One source of such information is peer behavior. The observable exit decisions of peers allow a manager to infer unobservable calculations (i.e. the calculation leading to the decision is not observed, only the final decision to exit) on the expected level of profitability (Baum et al., 2000; Miner and Haunschild, 1995). Based on their assessment of the accuracy of the information signal in these observations, managers may update their own beliefs about profitability levels. Managers may also conclude that despite any internal reservations they may have had about the strategies adopted by their peers, it could possibly pay to imitate their peers' decisions rather than deviate from them (Abrahamson and Rosenkopf, 1993). Finally, managers can either eschew individual analysis of the policy environment or augment it by imitating the strategic decisions of peers whose actions are perceived as legitimate (DiMaggio and Powell, 1983; Haunschild and Miner, 1997); following rules of thumb (March, 1988); or simply following habits (Geertz, 1978).

A second source of information is a firm's own experience. Firms with greater experience in a given environment should possess a greater appreciation of the

subtleties of local political discourse. This appreciation provides an advantage in discerning the identity and preferences of the pivotal political actors that influence the policies of interest to them (Holburn and Vanden Bergh, 2002; Krehbiel, 1999). Experienced firms are therefore better able to react to changes in the policy environment than their inexperienced counterparts that lack such information.

An alternative interpretation of the role of experience draws on the increasingly embedded nature of highly experienced firms in their environment. The distinction between a firm and its environment becomes increasingly blurred as its experience in that environment increases. As a result, experienced firms may be able to develop proactive influence strategies that both guard against inimical policy change and, potentially, initiate favorable policy change. Such influence strategies include the development of or participation in a lobbying coalition to deliver a message to pivotal actors tailored to maximize the likelihood that those who receive it will act upon it. A lobbying coalition may directly encompass political actors (formally, through equity participation, or informally through kickbacks to offshore bank accounts). The coalition may also include friends, family members or supporters of political actors, so as to indirectly influence policy outcomes. Even in the absence of such influence, highly experienced firms may be perceived to possess it by outsiders and observers.

The value of information increases with political hazards and in the aftermath of a regime change. Understanding the preferences of key actors, the formal and informal rules that govern their interaction and the framing devices to which they are most likely to respond helps to generate an accurate depiction of the likely evolution of relevant policies. Accurate forecasts gain in strategic importance as political hazards and thus the potential range of feasible policies increases. Similarly, experience accumulation can provide information about the key actors and preferences associated with, or leading to, a regime change. Once again, such information increases the reliability of forecasts that a firm can employ to design and implement adaptive strategies.

By contrast, the performance effect of actual or perceived influence differs in hazardous political environments as compared with environments that have undergone a regime change. So long as the regime remains stable, the actual or perceived influence over the policy environment generates direct benefits in terms of policy outcomes or, at least, reduced competition from other firms who seek to avoid confrontation with a firm perceived to have influence over the policy environment. A firm that has or is perceived to have influence over an existing set of political actors, interest groups and institutional processes may not, however, be able to unwind or alter its position in the event of a radical shift in the political environment, such as a regime change. Changes in the political regime can fundamentally alter the interest groups represented in government and the nature of interactions among political institutions. These changes in turn will reduce the value of past investments in cultivating contacts, developing lobbying coalitions and delivering messages, which were made for the purpose of influencing policies in the old political regime. Given this potential

depreciation in the value of past investments and the large fixed costs to begin anew under a new political regime, the efficacy of influence strategies will decrease with the incidence of regime change. Further, the resources built to influence the old regime may even become liabilities if a new regime seeks retribution against firms too closely identified with its predecessor.

Hypotheses

Information

Prior peer exits

One information strategy for managing policy uncertainty follows from the idea that a firm's managers can imitate the decisions of peer firms in order to contend with uncertainty from the political environment. This idea has strong roots in neo-institutional theory, the literature on rational bandwagons and Bayesian models of decision-making.

Neo-institutional theory posits that inter-organizational linkages (Haunschild, 1994) and reference groups (Greve, 2000; Haunschild and Miner, 1997) influence organizational exit rates by providing an organization with support or legitimacy (Ingram and Baum, 1997). Under conditions of uncertainty, organizations turn to the behavior of peers, which drives the process of mimetic isomorphism, or the process by which organizations become more similar over time (DiMaggio and Powell, 1983). Imitation can emerge as an organizational strategy because repeated actions by other organizations convey legitimacy and pressure organizational actors to adopt similar decisions, thus inducing the spread of a decision, structure or strategy across a set of organizations (Fligstein, 1985).

Imitation under conditions of uncertainty may also involve a technical rationale (Abrahamson and Rosenkopf, 1993). Research indicates that the strength of the technical rationale is related to the salience of an imitable organizational structure or strategy. When an organizational action has an observable outcome (Haunschild and Miner, 1997), or an organization's environment is somewhat predictable (Argote et al., 1990), salience is greater, as is the strength of the technical rationale. This latter point relates to the idea that imitative behavior can be a result of vicarious learning about organizational actions in unequivocal settings in which the results of a strategy are observable (Baum et al., 2000; Levitt and March, 1988). Earlier work in the Japanese banking industry highlights the role of such learning processes in market niche entry decisions (Greve, 2000).

Research on rational bandwagons conveys a similar prediction. Organizations can exhibit similarity and clustering in decisions and outcomes, such as organizational adoption, based on a concern that deviating from the practices of early adopters will carry negative performance consequences (Abrahamson and Rosenkopf, 1993). Not all bandwagon effects are strictly

technical, however. Bandwagon imitation can occur even in the presence of negative information on the performance of early adopters, or where there is uncertainty about the long-term performance implications of a strategy (Rosenkopf and Abrahamson, 1999).

Another technical rationale for the adoption of strategies previously used by one's peers relies on the assumption of incomplete information, which can lead managers to infer profitable strategies for their own organization based on the behavior of other organizations that share similar traits (Bikhchandani et al., 1998). Note that parallel to the arguments of social legitimacy or rational bandwagons, arguments that hinge on Bayesian updating also conclude that uncertainty enhances the tendency to imitate other organizations.

Consistent with each of these three theoretical perspectives we posit that as all multinational firms face substantial uncertainty in the operations of their overseas subsidiaries, they should imitate prior peer exits. As political hazards increase, uncertainty increases as well and the behavior of peer firms thus has an enhanced impact.

> **HYPOTHESIS 1 (H1)**   Prior peer exits have a positive effect on subsidiary exit rates.

> **HYPOTHESIS 2 (H2)**   The positive effect of prior peer exits on subsidiary exit rates increases according to the level of political hazards.

Own firm's experience

A second source of information is a firm's own prior experiences because these firms with accumulated experience can more accurately forecast the future policy environment and implement adaptive strategies to lower the expected volatility of net earnings. Barkema et al. (1996) and Pennings et al. (1994) provide empirical evidence consistent with such learning processes in their respective studies of expansion into new geographic and new product markets characterized by market and cultural uncertainty.

In the case of political hazards, experienced managers can develop a better understanding of the nature of coalitions that might be formed, the preferences of policy-makers, the compromises that a given political party or interest group are willing to make, the length of time it will take for a policy innovation to be enacted or other context-specific information that facilitates the delimitation of a choice set for their analysis (Geertz, 1978). Managers can use this information to identify those pivotal actors for whom a shift in preferences will generate the largest change in the final policy outcomes (Holburn and Vanden Bergh, 2002). These actors can include politicians, interest groups and alliance partners with strong political connections (Hitt et al., 2000). An understanding of the identity and preferences of these pivotal actors will enhance the accuracy of forecasts of the future policy environment and facilitate adaptations in a firm's strategy on pricing, sourcing, marketing and so on.

The same informational benefits that facilitate the forecasting of future policy in an existing political regime should also enhance a firm's ability to forecast and adapt to changes in policy resulting from a change in the current political regime. Experienced firms have good information not only about the identity and preferences of existing pivotal actors and the process of policy-making in the current set of political institutions, but also about the identity and preferences of opponents to the regime and the nature of the political institutions that they might put into place should they succeed in supplanting it. Once again, experience facilitates the development of adaptive market-based strategies to regime change. Consequently, the more experienced a firm the better should be its performance in the face of political hazards or regime change.

> HYPOTHESIS 3 (H3)   As political hazards increase, an organization's experience under the current political regime conveys useful information about the future policy environment and therefore has an increasingly negative effect on its subsidiaries' exit rates.

> HYPOTHESIS 4A (H4A)   In the event of a change in the political regime, an organization's experience under the previous political regime conveys useful information about the new political regime and therefore has a negative effect on its subsidiaries' exit rates.

Influence

Proactive influence strategies employ the information gained about the identity and preferences of pivotal actors and the process of policy-making to alter policy outcomes. In other words, the managers of a firm that adopts an influence strategy no longer assume that policies are exogenously determined but rather that policies are under their strategic influence. As a result, firms take steps to develop an influence strategy that can reduce the potentially harmful effect of policy uncertainty and even secure advantageous policy change.

As accumulated experience yields information so too does experience enhance the efficacy of influence strategies. Prior experience will not only aid with the identification of pivotal actors in a country's political environment but it can also facilitate the implementation of a lobbying strategy that can most cost-effectively alter the opinion of these actors and, thereby, policy outcomes (Henisz and Zelner, 2003, 2005).

Although refining and exploiting an organization's influence strategy in a specific political context reinforces an organization's competences to manage future policy uncertainty in that same environment, it is important to note that such actions carry the potential of maladaptation should the context change radically (Amburgey and Miner; 1992, Greve, 1999; Ingram and Baum, 2001). In this regard, regime change concerns managers because of its potentially radical impact on the success criteria for their influence over the policy environment.

As success criteria can change, the organizational experience gained under a given political regime might provide little benefit to the management of policy uncertainty instigated by a regime change. Resources fundamental to an influence strategy, such as cultivated contacts and learned routines regarding lobbying processes, tend to be highly applicable to one political regime, but are imperfectly redeployable to a succeeding regime, perhaps even becoming a liability in the aftermath of a regime change. Even firms that do not possess undue influence may be perceived as having benefited from an association with a deposed regime and will suffer at the hands of the newly installed regime.

A straightforward example of this is the strategy of partnering with a Suharto family member in Indonesia. Such partnerships greatly enhanced performance up to 1997, but they greatly enhanced exit rates after the change in the regime and the launching of a campaign against corruption, cronyism and nepotism by Suharto's successors which targeted all firms that enjoyed close ties to the Suharto family or were perceived to enjoy such. This form of maladaptation can enhance rates of exit, if prior experience becomes a liability, such as after a transition to a new regime. Although an influence-based strategy generates the same prediction as an information-based strategy with respect to the effect of experience in politically hazardous environments, in the case of a regime change we make an opposite prediction to that for information-based strategies.

> HYPOTHESIS 4B (H4B)   In the event of a change in the political regime, the actual or perceived influence associated with an organization's experience under the prior political regime depreciates rapidly or can even become a liability and thus has a positive effect on its subsidiaries' exit rates.

Methods

Data sources and sample

We test these hypotheses using longitudinal data on the foreign manufacturing subsidiaries of Japanese manufacturing firms. Japan has been a leading source of manufacturing FDI, which has flowed to an extensive number of countries. According to our data sources, by 2000 more than 52 countries had received Japanese manufacturing FDI, with 19 countries possessing at least 100 Japanese manufacturing subsidiaries and another 10 possessing at least 30. This large country spread provides the variance we require on our measures of political hazards and regime change, to test this study's hypotheses, while controlling for other country-level influences on exit rates.

We derived our sample from the list of subsidiaries provided in Toyo Keizai's compendium of FDI, *Japanese Overseas Investment*. We used each annual edition from 1992 to 2001 to construct longitudinal profiles of Japanese subsidiaries for the period 1991–2000. These profiles included information on the country in which and date on which a subsidiary was establishment; and the

year of subsidiary exit, if an exit occurred. This process identified 28,525 subsidiaries that existed in the 1991–2000 period, of which 34.6% (9859 subsidiaries) had exited by 2000.

As the capital costs and limited redeployability of manufacturing assets make exit a more critical and less reversible business decision, we focused on the analysis of manufacturing subsidiaries where exit is more reasonably associated with unacceptable subsidiary performance than would be the case for service-sector entrants. We limited our sample to subsidiaries formed in the 1991–2000 period, in order to remove left-censored cases from our analysis.

Left-censored cases would be subsidiary entries made before 1990, but which also exited before 1990. It is possible to trace FDI entries and exits back to the early 1970s, using our source. Doing so, however, would not increase our coverage in a proportional manner. Japanese FDI levels doubled each decade from the 1970s to the 2000s. Hence extending our coverage back to 1970, with an additional 20 years of data, would result in a sample about 1.67 times our current sample size. Although our sample comes from the 1991–2000 period, our independent measures of investment experience, density and the like are, where appropriate, drawn from the full sample of surviving observations including those formed before 1991. Even so, it is important to note that not having the full history of Japanese FDI means that experience calculated for subsidiaries founded before 1990 has a bias towards the experience of surviving subsidiaries. Those subsidiaries that were founded and exited prior to our sample period would not contribute to the construction of our experience measures and we are, as a result, unable to distinguish between the information gained from successful past entries and failed entries (Ingram and Baum, 1997).

Using these criteria for sample selection, our final sample comprised 2283 manufacturing subsidiaries, formed in the 1991–2000 period by 642 Japanese manufacturing firms in 52 countries of which 17.7% (405 subsidiaries) had exited by 2000. This sample includes considerable variance on our measures of cross-firm and within-firm experience under current and previous regimes, as supported by the descriptive statistics presented in Table 1.

Dependent variable

Our dependent variable, *Exit*, was an indicator variable, E_{xt}, that took a value of 1 if subsidiary x exited at time t. Observations started in the year 1992, continued until an exit occurred, or were right-censored in 2000, if the indicator variable E_{xt} was zero in each year t for subsidiary x. Exits occurred in 38 of the 52 countries, with the highest count of exits in China (105), the United States (88), Thailand (29), Taiwan (20), the UK (19), Indonesia (19), Malaysia (19), Hong Kong (14), France (13) and Germany (12). The highest exit rates were recorded in Spain (6.9%), Ireland (6.8%), Germany, Sweden, Poland and Sri Lanka (each 6.7%), Brazil (5.9%), Finland (5.9%), France (5.9%), Hong Kong (5.7%), the United States (5.0%) and Taiwan (4.9%).

Independent variables

Political hazards

The political hazards index ('political hazards') (Henisz, 2000a) was designed to measure the extent to which a change in the preferences of any one actor may lead to a change in government policy. The first step in its construction was the identification of the number of independent branches of government (executive, lower and upper legislative chambers, judiciary and states or provinces) with veto power over policy change. The preferences of each of these branches and the status-quo policy were then assumed to be independently and identically drawn from a uniform, unidimensional policy space. This assumption allows for the derivation of a quantitative measure of policy uncertainty using a simple spatial model of political interaction. The initial measure is then modified to take into account the extent of alignment across branches of government using data on the party composition of the executive and legislative branches. Alignment across branches increases the feasibility of policy change. The measure is then further refined to capture the extent of preference heterogeneity within each legislative branch. Greater within-branch heterogeneity increases the costs of overturning policy for aligned branches.

The main results of the derivation are that first, each additional veto point (a branch of government that is both constitutionally effective and controlled by a party different from other branches) provides a negative but diminishing effect on the total level of political hazards; and second, homogeneity (or heterogeneity) of party preferences within an opposed (or aligned) branch of government is negatively correlated with the level of political hazards. Scores for political hazards for a given country in a given year ranged from 0.1 (minimal hazards) to 1.0 (extremely hazardous).[1] The 10 countries with the highest political hazards that received Japanese FDI were Cambodia, China, Indonesia, Iran, Myanmar, Pakistan, Russia, Saudi Arabia, Sri Lanka and Vietnam. The 10 countries with the lowest political hazards were Australia, Belgium, Canada, Chile, Denmark, Finland, Israel, Slovak Republic, Switzerland and the United States.

We measured the change in political hazards from the time that a subsidiary entered a host country. Subsidiaries in Hong Kong, Pakistan, Sri Lanka, Thailand and Venezuela experienced the largest increases in political hazards. Outside the substantial swings in these countries, 68% of countries accounting for 47% of the country-subsidiary-years of observations in which there was a change in political hazards in the 1991–2000 period.

Regime change

We adopt the coding of the Polity database (Gurr, 2001) to measure regime change. This dataset is a widely adopted source of information on the evolution of political institutions across time. A political regime or polity is defined by the authors of that dataset, following *Webster's New World College Dictionary*, as a

'political or governmental organization; a society or institution with an orga-nized government; state; body politic'. A regime change occurs when one politi-cal regime or polity is replaced by another political regime or polity, as distinguished in the definition. Formally, such a change occurs when a change of 3 points on the 21-point Polity index occurs within a three-year interval. Conceptually this is a substantive and rapid change in the extent of democracy or autocracy in a narrow timeframe. Indexes examining the competitiveness of executive recruitment for the executive branch of the government, the openness of executive recruitment for the government, the constraints on the executive and the regulation or competitiveness of political participation are combined into a single ordinal score. This measure has been used in hundreds of published studies in the political science literature, including papers exploring the rela-tionship between regime type or regime change and economic performance, war, political structure, human rights, trade and migration. Aside from the examples cited above, regime changes in countries with Japanese FDI include the restoration of democracy in Thailand in 1993, Pakistan's military coup in 2000 and the end of the Suharto regime in Indonesia in 2000. Prior regime changes have an effect on the subsample of firms in our dataset that had accumu-lated experience under such deposed regimes as the communist governments of Hungary, Poland and the Czech Republic before 1990, the Pinochet government in Chile before 1989, Korea before its democratization in 1988, the Philippines under Marcos before 1986, the military governments in place in Brazil, Pakistan and Argentina before 1986, 1985 and 1983 respectively and so on.

Prior peer exit

To measure the prevalence of mimesis in exit behavior (Greve, 1995), we con-structed three measures of the percentage of peer subsidiaries that exited in the prior year. Our three peer groups were other subsidiaries in the same 3-digit SIC industry and country as a focal subsidiary, other subsidiaries in the same country and in the same horizontal business group and other subsidiaries in the same country and in the same vertical business group.

A horizontal business group in Japan is typically called a horizontal *keiretsu* or *kigyou shudan*. As with horizontal business groups in other countries such as South Korea and India, a horizontal group in Japan comprises numerous (from 20 to more than 100) distinct legal corporate entities that operate in different business segments, but are linked together through such mechanisms as cross-shareholdings, personnel exchanges, long, shared histories and regular meetings between CEOs and senior executives. A vertical business group, or a vertical *keiretsu*, is a series of legally distinct companies that operate in different vertical positions in the same broad industry segment, such as automotives, but are connected through a set of sometimes proprietary, long-standing buyer–supplier relationships in the industry (Lincoln et al., 1996). Our source for identifying business group membership was the horizontal and vertical organ-izational affiliations provided in Dodwell's publication, *Industrial Groupings in*

Japan: The Anatomy of Keiretsu. The peer exit measures are time-varying and lagged by one year. The mean (and standard deviation) of peer exit rates is 3.0% (5.9%) when peers are defined by a 3-digit SIC industry grouping; 1.1% (0.4%) when peers are defined by horizontal *keiretsu* affiliation; and 0.31% (0.34%) when peers are defined by vertical *keiretsu* affiliation.

Organizational experience

Using the same data on regime change coded retrospectively to the time of the first recorded instance of Japanese FDI, we calculated annual measures of 'Host country experience under the political regime in place at the beginning of the year' and 'Host country experience under previous political regimes' as the log of the years of investment history a firm possessed under the current structure of political institutions (those in existence on 1 January of the reporting year) and under its predecessors. The most embedded firm-country pairs were Panasonic, Sanyo, Nissan, Toyota and Honda in the United States. The most embedded non-US pairs were Matsushita, Panasonic and Sanyo in China. Other highly embedded non-US pairs included Toray in Indonesia, Honda Motor in Brazil, Kobe Steel in Singapore and Oji Paper in Canada.

Industry, firm and subsidiary controls

Prior research indicates that an important source of information about a firm's environment is the decisions of peer firms (Haunschild, 1994; Rosenkopf and Abrahamson, 1999). To capture national population-level effects of legitimation and competition (Hannan and Freeman, 1989), we measured the density of Japanese firms' activities in the host country of a focal subsidiary. Given the absence of comparable data on the multinational spread of firms from other countries, we follow previous work in the international arena and operationalize this construct using the population of Japanese subsidiaries alone (Mitchell et al., 1994). 'Density' was the number of Japanese subsidiaries operating in a given year in a focal subsidiary's industry and country. We introduced both raw counts and a quadratic term.

To account for the levels of flexibility a firm has to shift production from one location to the next in response to shocks (Bartlett and Ghoshal, 1990; Kogut, 1983) we included 'Other subsidiaries, world'. We defined this measure as the number of foreign subsidiaries owned by a firm in a given year. 'Other subsidiaries, host country' was the number of foreign subsidiaries owned by a firm in a host country in a year. To examine the role of own firm exits in other countries to control for firm-specific factors that could lead to a global retrenchment independent of environmental uncertainty and to control for unobserved firm-level factors that could lead to a pattern of global exits by a firm, we included a count of 'Exits, rest of world', which was the number of subsidiaries of a firm that exited in a given year.

To account for the effect of organizational ties (Pfeffer and Salancik, 1978), we developed two measures of a firm's business group affiliations: 'horizontal

business group' and 'vertical business group'. These indicator variables respectively marked whether a firm had an affiliation with any of the horizontal groups, or any of the vertical groups, in Japan.

Finally, we included firm 'age' and 'subsidiary age' and their square terms in all models to examine for liabilities of newness (Freeman et al., 1983), adolescence (Bruderl and Schussler, 1990) and age (Barron et al., 1994). We measured firm size with the logarithm of 'firm employment' (Freeman et al., 1983). We sourced these time-varying measures from the Nikkei NEEDS tapes and Japanese Overseas Investment.

Country controls

Country-level determinants of subsidiary exit rates could include market demand and market potential (Carroll and Hannan, 1989). We included the log of two time-varying, lagged measures: 'Log (GDP per head)' and 'Log (population)', as sourced from the World Development Indicators 2002 of the World Bank.

Fixed effects

We used regional indicator variables as proxies for transportation costs and cultural differences and, to some extent, for differences in investment motivations that may influence exit rates, as well as to capture time-invariant differences across world regions: Africa, Asia, Central and Eastern Europe, Central America and the Caribbean, former British colonies, the Middle East, South America and western Europe. Annual fixed effects capture variation in exchange rates and global economic conditions. Industry fixed effects capture sectoral variation in exit prevalence at the Japanese equivalent of a 3-digit SIC code.

Summary statistics

Tables 1 and 2 provide a correlation matrix including interaction terms. Note that we mean-centered all interaction terms, thereby reducing concerns of multi-collinearity as demonstrated by the weak correlations among the mean-centered interaction terms and their constituent variables (none exceeds 0.32 and only two exceed 0.13). Table 2 provides descriptive statistics for the variables included in the full sample and the subsamples in which exit did and did not occur.

Modeling procedure

We estimated exit rates using event history analysis, as implemented by an exponential model. Event history analysis uses a longitudinal record of events in a sample from a population to examine the influences that a set of covariates have on an event. Our focal event is an exit by a subsidiary. In the analysis, each subsidiary x is at risk of exit from country i in each time period t, or until its exit

Table1 Correlation Matrix

Measure	1	2	3	4	5	6	7	8	9
1. Exit									
2. Political hazards	-0.05								
3. Change in political hazards since entry	0.02	0.19							
4. Change in regime	0.03	0.05	0.01						
5. Experience under the political regime in power at the beginning of the year (log)	0.07	-0.13	-0.04	-0.25					
6. Experience under other political regimes (log)	0.03	-0.09	-0.02	0.40	-0.02				
7. Experience under the political regime in power at the beginning of the year (log) × political hazards (mean–centered)	-0.03	0.01	-0.04	-0.06	-0.08	-0.12			
8. Experience under the political regime in power at the beginning of the year (log) × regime change (mean–centered)	0.02	-0.02	0.00	-0.03	0.01	0.16	0.04		
9. Experience under other political regimes (log) × political hazards (mean–centered)	0.00	-0.07	0.25	0.12	-0.13	-0.32	-0.06	-0.01	
10. Experience under other political regimes (log) × regime change (mean–centered)	-0.02	-0.03	0.00	-0.26	0.07	-0.07	0.05	0.09	-0.09
11. Prior year's exits by firms in same 3-SIC	0.07	-0.04	0.02	0.06	0.11	0.03	-0.04	0.02	0.00
12. Prior year's exits by firms in same horizontal business group	0.02	-0.07	0.02	0.06	0.06	0.03	-0.02	0.04	0.04
13. Prior year's exits by firms in same vertical business group	0.03	-0.03	0.00	0.02	0.03	0.01	-0.04	0.01	0.01
14. Subsidiary age	0.09	0.01	-0.10	0.08	0.29	0.10	0.06	0.03	0.05
15. Subsidiary age^2	0.07	-0.01	-0.11	0.07	0.24	0.10	0.04	0.04	0.06
16. Firm age	-0.01	0.04	0.03	0.02	0.12	0.09	0.03	0.03	-0.04
17. Firm age^2/1000	0.00	0.04	0.03	0.02	0.11	0.09	0.02	0.03	-0.03
18. Member, horizontal business group	-0.02	-0.01	0.00	0.01	0.08	0.04	0.02	0.03	-0.01
19. Member, vertical business group	-0.01	0.02	-0.02	0.01	0.15	0.01	0.01	0.02	-0.02
20. Employment (log)	0.00	0.05	0.00	-0.01	0.39	0.11	0.04	0.07	-0.09
21. Other exits by focal firm in rest of world	0.09	0.05	0.00	0.03	0.29	0.10	0.08	0.06	-0.02
22. Other subsidiaries, rest of world	0.00	0.09	0.00	0.00	0.47	0.09	0.09	0.07	-0.08
23. Other subsidiaries, host country	0.04	0.10	0.02	-0.05	0.68	0.01	0.10	0.04	-0.09
24. Host country – industry density	0.00	0.10	0.02	-0.07	0.20	-0.09	-0.06	0.00	-0.06
25. Host country – industry density^2/1000	0.01	0.00	0.02	-0.05	0.17	-0.07	-0.07	0.00	-0.01
26. Gross Domestic Product (log)	0.07	-0.81	0.08	0.01	0.22	0.04	-0.12	0.02	0.22
27. Population (log)	-0.04	0.68	0.00	-0.09	0.14	-0.20	-0.06	-0.01	-0.14

occurs. This technique models the rate of a transition from an origin state to a destination state (exit) as a function of the covariates. Its general form is:

$$r_{jk} = \exp (\alpha_{jk0} + A_{jk1}\alpha_{jk1} + A_{jk2}\alpha_{jk2}...)$$

where r_{jk} is the transition rate from origin state j to destination state k, with the observed covariate vector A_{jk}, parameters to be estimated α_{jk} and constant α_{jk0}. The duration of an event is described by an exponential distribution. The relationship between the covariates and the transition rate is specified as log-linear to ensure transition rate estimates are not negative.

10	11	12	13	14	15	16	17	18	19	20	21	22	23	24	25	26
–0.02																
–0.01	0.05															
0.04	0.05	0.03														
–0.07	0.10	0.06	0.01													
–0.06	0.09	0.06	0.01	0.94												
–0.01	0.01	0.11	0.00	0.07	0.06											
–0.01	0.01	0.11	0.00	0.06	0.06	0.98										
0.01	–0.01	0.48	0.01	–0.01	–0.01	0.17	0.17									
0.01	0.02	0.07	0.22	–0.02	–0.02	0.03	0.02	0.13								
0.02	0.01	0.06	0.05	–0.03	–0.03	0.24	0.23	0.17	0.33							
–0.01	0.04	0.06	0.01	0.11	0.10	0.07	0.07	0.06	0.25	0.46						
0.02	0.02	0.01	0.04	0.02	0.02	0.14	0.13	0.06	0.41	0.74	0.64					
0.03	0.07	0.02	0.03	0.05	0.03	0.10	0.09	0.09	0.24	0.50	0.42	0.70				
0.01	0.07	–0.01	0.01	0.04	0.02	–0.05	–0.05	–0.04	0.05	0.02	–0.01	0.02	0.18			
0.01	0.05	–0.01	0.01	0.02	0.00	–0.04	–0.04	–0.04	0.04	0.03	–0.01	0.01	0.13	0.92		
0.00	0.08	0.10	0.04	0.03	0.04	–0.02	–0.02	0.02	–0.03	–0.05	–0.06	–0.10	–0.02	–0.05	0.05	
0.02	0.04	–0.03	0.00	0.01	–0.01	0.03	0.03	–0.01	0.05	0.07	0.05	0.12	0.27	0.32	0.19	–0.65

The estimation uses the maximum likelihood method (Blossfeld and Rohwer, 1995). To estimate this model, we expanded the base sample into multiple spells that included all subsidiary–country–year combinations among the subsidiaries, countries and annual time periods in which an exit could occur. In each spell, a subsidiary was at risk of exiting and was treated as right-censored unless an exit occurred. Once we divided the data into annual spells, we had as many as 12,206 observations, but this dropped to 10,002 after casewise deletion of observations with missing independent variables.

Table 2 Descriptive statistics

Measure	Full sample				Surviving subsidiaries				Exiting subsidiaries			
	Mean	S.D.	Min	Max	Mean	S.D.	Min	Max	Mean	S.D.	Min	Max
1. Exit	0.03	0.17	0.00	1.00	0.00	0.00	0.00	0.00	1.00	0.00	1.00	1.00
2. Political hazards	0.59	0.38	0.11	1.00	0.60	0.38	0.11	1.00	0.50	0.37	0.11	1.00
3. Change in political hazards since entry	−0.01	0.12	−0.77	0.74	−0.01	0.12	−0.77	0.74	0.00	0.13	−0.76	0.66
4. Change in regime	0.02	0.14	0.00	1.00	0.02	0.14	0.00	1.00	0.04	0.20	0.00	1.00
5. Experience under the political regime in place at the beginning of the year (log)	2.26	1.34	0.00	5.77	2.25	1.34	0.00	5.77	2.73	1.38	0.00	5.57
6. Experience under other political regimes (log)	0.30	0.89	0.00	5.20	0.29	0.88	0.00	5.20	0.41	1.03	0.00	4.36
7. Experience under the political regime in place at the beginning of the year (log) × political hazards (mean-centered)	−0.06	0.52	−1.56	1.33	−0.05	0.52	−1.56	1.33	−0.16	0.56	−1.46	1.26
8. Experience under the political regime in place at the beginning of the year (log) × regime change (mean-centered)	0.00	0.17	−2.26	2.88	0.00	0.16	−2.26	2.88	0.02	0.20	−1.57	1.76
9. Experience under other political regimes (log) × political hazards (mean-centered)	−0.04	0.31	−1.66	1.98	−0.04	0.31	−1.66	1.98	−0.03	0.36	1.44	1.52
10. Experience under other political regimes (log) × regime change (mean-centered)	0.00	0.09	−0.30	4.73	0.00	0.09	−0.30	4.73	−0.01	0.06	−0.30	0.00
11. % of 3–SIC peer subsidiaries that exited in the prior year	0.03	0.06	0.00	0.67	0.03	0.06	0.00	0.67	0.06	0.09	0.00	0.67

Variable												
12. % of horizontal business group peer subsidiaries that exited in the prior year	0.01	0.04	0.00	1.00	0.01	0.04	0.00	1.00	0.02	0.06	0.00	1.00
13. % of vertical business group peer subsidiaries that exited in the prior year	0.00	0.03	0.00	1.00	0.00	0.03	0.00	1.00	0.01	0.07	0.00	1.00
14. Subsidiary age	2.87	2.26	0.00	9.00	2.85	2.27	0.00	9.00	3.45	1.81	1.00	8.00
15. Subsidiary age^2	13.34	16.92	0.00	81.00	13.28	16.97	0.00	81.00	15.16	15.04	1.00	64.00
16. Firm age	60.13	17.58	7.00	116.58	60.15	17.54	7.00	115.58	59.46	18.68	15.00	116.58
17. Firm age^2/1000	3.92	0.23	0.00	13.59	3.93	0.23	0.00	13.36	3.88	2.55	0.23	13.59
18. Member, horizontal business group	0.28	0.45	0.00	1.00	0.28	0.45	0.00	1.00	0.24	0.43	0.00	1.00
19. Member, vertical business group	0.17	0.38	0.00	1.00	0.17	0.38	0.00	1.00	0.16	0.36	0.00	1.00
20. Employment (log)	8.22	1.37	3.00	11.31	8.22	1.37	3.00	11.31	8.19	1.38	3.74	11.22
21. Other exits by focal firm in rest of world	1.29	2.82	0.00	29.00	1.24	2.74	0.00	29.00	2.97	4.42	0.00	25.00
22. Other subsidiaries, rest of world	34.15	39.16	1.00	246.00	34.12	39.30	1.00	246.00	35.02	33.96	1.00	246.00
23. Other subsidiaries, host country	4.33	5.74	1.00	39.00	4.29	5.71	1.00	39.00	5.56	6.50	1.00	32.00
24. Host country – industry density	31.24	37.54	1.00	204.00	31.26	37.47	1.00	204.00	30.64	39.73	1.00	204.00
25. Host country – industry density^2 /1000	2.39	5.81	0.00	41.62	2.38	5.79	0.00	41.62	2.51	6.47	0.00	41.62
26. Gross Domestic Product (log)	7.92	1.57	5.43	10.94	7.90	1.56	5.43	10.94	8.55	1.38	3.74	11.22
27. Population (log)	19.07	1.70	12.98	20.96	19.08	1.70	12.98	20.96	18.73	1.69	15.08	20.95

Results

Table 3 presents the results of our analysis. We did not report their coefficient estimates, but the year, region and 3-digit SIC industry indicator variables substantially improved the model's explanatory power. Models 1–4 present coefficient estimates for the national, industry, firm and subsidiary-level control variables. Statistically significant coefficient estimates of less than zero indicate a reduction in exit rates, and estimates greater than zero indicate an increase.

None of the country-level economic controls (industry density and the macroeconomic aggregates) was associated with exit rates. Subsidiary age is positively associated with exit rates and firm age is initially negatively associated, but eventually also positively associated with exit rates. Membership in a horizontal business group reduces subsidiary exit rates. Neither membership in a vertical business group nor size had an effect on subsidiary exit rates. Firms with a larger global scope of operations experienced lower subsidiary exit rates and firms with a larger local scope of operations had higher ones, consistent with the notions that other international operations increase a firm's leverage in negotiating with the government, while larger local operations enhance a firm's flexibility to relocate production across local plants. We observed a strong positive relationship between a firm's exits in the rest of the world and the focal country, suggesting that corporate strategies of downsizing have a significant effect across multiple host countries independent of any country-specific considerations. As we expected, we observed no direct relationship between the level of political hazards and subsidiary exit rates. In contrast, change in political hazards (weakly) and regime change are both positively associated with exit rates. Finally, when we include only the main effect, we observe a positive association between our two measures of organizational experience and exit rates.

Model 5 adds the theoretical variables of interest, using interaction terms between the measures of own-firm experience and political hazards and regime change to test H3, H4a and H4b. We were unable to include the interaction between experience in other political regimes and regime change due to the collinearity between the variable regime change and this interaction, given that we observed only one firm to exit that had such experience in the year of a regime change. We were also unable to test H2 using interaction terms, due to the high degree of collinearity across the three measures of peer exit and between these interaction terms and those involving the experience measures. Further, when we removed the experience interactions and included interaction(s) between measures of peer exit and political hazards, we observed that these effects were highly nonlinear. Specifically, whereas peer exits with political hazards above a threshold level of approximately 0.25 (roughly the threshold between well-established democracies and other countries) had a strong positive effect on exit rates, peer exits in countries with lower political hazards (e.g. Australia, Belgium, Canada, Germany, Italy, the Scandinavian countries, Switzerland and the United States) had no effect. As a result, instead of using

interaction terms to test H2 (and as a means to provide an alternative test for H3, H4a and H4b), we provide coefficient estimates for the independent effect of peer exits (and own-firm experience) in the full sample (model 6), the sub-sample where political hazards are above the mean (model 7) and the subsample where political hazards are below the mean (model 8).

Consistent with H1, we observe a positive association between prior peer exits and exit rates using two of the three measures in model 5 (the coefficient estimate on the third measure – exits by vertical business group peers – is positive but with a *p*-value of only 0.10). Removing the interaction terms that include political hazards (model 6) does not alter these results. We note that the coefficient estimates for these variables are remarkably similar, suggesting that the economic magnitude of the effect of a given percentage of prior exits by any of these three types of peer firms is relatively comparable. Note, however, that sample means and standard deviations for exits by firms in the same industry substantially exceed those for exits by firms in the same horizontal business group, which in turn exceed those for exits by firms in the same vertical business group. Thus, while the effect of an equivalent increase in percentage of peers exiting is comparable across these three peer groups, more of the variance in observed exits is explained by the prior exit of peers from the same industry than prior exits by peers from the same horizontal business group, which in turn explains more of the variance than prior exits by peers from the same vertical business group.

This similarity in the influence of peer exits is maintained for vertical and horizontal *keiretsu* peers in the subsample tests (models 7 and 8), but not for industry peers. When we split the sample, we observe that, consistent with H2, prior peer exits by firms in the same horizontal or vertical business group are much more strongly (in both economic and statistical terms) associated with exit rates when political hazards are above the mean (model 7) than when political hazards are below the mean (model 8). We do not observe an analogous difference for prior exits by firms in the same 3-digit SIC. In fact, with the loss of statistical power associated with the halving of sample size, we are unable to find a positive association between prior exits by firms in the same industry and exit rates either when political hazards are above or below the mean. The split sample results indicate that political uncertainty is an important precursor to a firm's imitation of organizationally related peers, but for industry peers the level of uncertainty does not appear to moderate the prevalence of imitative behavior.

An examination of the coefficient estimates on our interaction terms between the measures of own-firm experience and 'political hazards' and 'regime change' (model 5) demonstrates that instead of acting as an unconditional liability, experience can enhance or reduce predicted exit rates depending on the state of the political environment. Specifically, whereas experience under the political regime in place at the beginning of the year reduces exit rates when political hazards are high (i.e. the coefficient estimate on the mean-centered interaction term between own-firm experience and political hazards is negative

Table 3 Political hazards, regime change, experience and subsidiary exit rates[1]

Variable	Model 1	Model 2	Model 3	Model 4	Model 5	Model 6	Model 7[2]	Model 8[3]
% 3–SIC peers that exited in the prior year (H1 > 0)					1.321	1.375	1.111	0.347
					0.017	*0.011*	*0.352*	*0.620*
% horizontal business group peers that exited in the prior year (H1 > 0)					1.301	1.344	3.737	–1.049
					0.024	*0.013*	*0.000*	*0.502*
% vertical business group peers that exited in the prior year (H1 > 0)					1.253	1.282	3.540	0.787
					0.099	*0.075*	*0.017*	*0.266*
Experience under the political regime in place at the beginning of the year (Log) × political hazards (H3 < 0)					–0.239			
					0.034			
Experience under the political regime in place at the beginning of the year (Log) × change in political regime (H4a < 0; H4b > 0) (mean-centred)					0.405	0.358	0.705	0.276
					0.008	*0.018*	*0.012*	*0.218*
Experience under other political regimes (Log) × political hazards (mean-centred)					–0.218			
					0.257			
Experience under the political regime in place at the beginning of the year (Log) (mean-centred)				0.194	0.137	0.204	0.042	0.362
				0.027	*0.150*	*0.017*	*0.808*	*0.001*
Experience under other political regimes (Log)				0.105	0.024	0.088	0.106	–0.062
				0.070	*0.741*	*0.160*	*0.611*	*0.463*
Political hazards			–0.326	–0.146	–0.143	–0.141	2.031	1.024
			0.362	*0.694*	*0.706*	*0.704*	*0.202*	*0.715*
Change in political hazards since the time of subsidiary entry			0.923	0.870	1.045	0.883	2.539	0.520
			0.098	*0.108*	*0.070*	*0.112*	*0.033*	*0.487*
Change in political regime			0.665	0.890	0.782	0.800	–0.892	2.403
			0.007	*0.007*	*0.033*	*0.021*	*0.269*	*0.000*
Subsidiary age		0.277	0.279	0.236	0.241	0.228	0.309	0.351
		0.016	*0.019*	*0.046*	*0.042*	*0.053*	*0.167*	*0.010*
Subsidiary age squared		–0.025	–0.023	–0.021	–0.021	–0.021	–0.033	–0.030
		0.092	*0.132*	*0.177*	*0.172*	*0.177*	*0.278*	*0.079*

Firm age		−0.046	−0.048	−0.048	−0.044	−0.044	−0.075	−0.024
		0.003	*0.003*	*0.003*	*0.006*	*0.006*	*0.001*	*0.268*
Firm age squared/1000		0.346	0.358	0.354	0.324	0.322	0.514	0.203
		0.003	*0.003*	*0.003*	*0.007*	*0.007*	*0.004*	*0.197*
Horizontal business group		−0.299	−0.313	−0.299	−0.366	−0.376	−0.533	−0.263
		0.022	*0.020*	*0.027*	*0.010*	*0.007*	*0.029*	*0.227*
Vertical business group		0.074	0.108	0.136	0.043	0.056	0.031	0.175
		0.659	*0.537*	*0.425*	*0.839*	*0.763*	*0.907*	*0.423*
Log (employment)		0.048	0.048	0.016	0.021	0.016	0.145	−0.041
		0.484	*0.486*	*0.804*	*0.746*	*0.807*	*0.146*	*0.607*
Other subsidiary exits, rest of world		0.157	0.160	0.157	0.153	0.153	0.177	0.153
		0.000	*0.000*	*0.000*	*0.000*	*0.000*	*0.000*	*0.000*
Other subsidiaries, rest of world		−0.021	−0.022	−0.022	−0.022	−0.022	−0.029	−0.021
		0.000	*0.000*	*0.000*	*0.000*	*0.000*	*0.000*	*0.000*
Other subsidiaries, host country		0.075	0.079	0.058	0.066	0.056	0.092	0.052
		0.000	*0.000*	*0.000*	*0.000*	*0.000*	*0.001*	*0.020*
Host country – industry density	0.010	0.006	0.006	0.005	0.005	0.005	0.002	0.017
	0.082	*0.296*	*0.272*	*0.328*	*0.353*	*0.347*	*0.907*	*0.018*
Host country – industry density^2/1000	−0.041	−0.025	−0.027	−0.025	−0.021	−0.022	−0.031	−0.065
	0.122	*0.335*	*0.310*	*0.338*	*0.436*	*0.399*	*0.772*	*0.036*
Gross domestic product (Log)	0.209	0.152	0.056	0.007	−0.005	−0.009	−0.474	−0.034
	0.034	*0.127*	*0.604*	*0.951*	*0.962*	*0.934*	*0.052*	*0.811*
Population (Log)	−0.030	−0.092	−0.083	−0.114	−0.126	−0.126	−0.242	−0.026
	0.637	*0.127*	*0.308*	*0.185*	*0.138*	*0.143*	*0.182*	*0.786*
N	12,206	10,147	10,002	10,002	10,002	10,002	4874	5128
Log–likelihood	−1252	−1110	−1081	−1076	−1068	−1070	−396.7	−602.4

Notes

1 *p*-values reported in italics under coefficient estimates. Region, time and industry indicator variables not reported.

2 Sub-sample for subsidiaries located in countries in which political hazards are above the sample mean.

3 Sub-sample for subsidiaries located in countries in which political hazards are below the sample mean.

in model 5), when that regime is replaced over the course of the year exit rates increase substantially (i.e. the coefficient estimate on the interaction term between own-firm experience and regime change is positive in model 5). We replicate these results in our split-sample analysis, finding that the liability of own-firm experience observed in the low political hazards subsample (model 8) is eliminated in the subsample with high political hazards (model 7), whereas own-firm experience is a liability in the event of regime change in a country with political hazards above the mean level (model 7).

These results provide good empirical support for the notion that experience provides actual or perceived influence as opposed to merely superior information. Specifically, as political hazards increase, the exit rates for firms with more experience under the political regime in power at the beginning of the year decline. We also find that these same firms have higher exit rates in the event of a change in regime. Note that the positive effect of regime change on exit rates is magnified by a firm's experience under the political regime in place at the beginning of the year. Such a finding runs counter to an information-based logic for experience which would posit that experienced firms should have anticipated the regime change and, if they believed it to represent a worsening of the policy environment to which they could not adapt, would therefore exit before the actual change in regime. Alternatively, if these firms believed the change in the environment would be one to which they could successfully adapt, they should react in a manner that would continue to result in a performance benefit as compared with their inexperienced counterparts.

An examination of hazard ratios for various combinations of the independent variables of theoretical interest, as depicted in Figure 1, demonstrates the economic significance of the results with respect to the conditional effect of own-firm experience. As predicted by H3, subsidiaries whose parents possess more experience under the political regime in power at the beginning of the year do relatively better as compared with their inexperienced counterparts, especially in more uncertain policy environments. Specifically, when political hazards are one standard deviation below the sample mean, the predicted exit rate for firms with one standard deviation above the mean level of experience under the political regime in place at the beginning of the year is 59% lower than for firms with the mean level of experience and 74% lower than firms with one standard deviation below the mean level. These benefits of experience increase to 82% and 90% respectively when the level of political hazards are one standard deviation above the mean. This effect is seen in Figure 1 by the steeper slope of the downward sloping schedule, corresponding to relatively high political hazards under a stable regime.

Contrast the downward sloping schedules corresponding to the effect of experience under a stable political regime with the upward sloping schedules corresponding to the effect of experience in the year of a regime change. The schedules have shifted upward, denoting the fixed positive effect that regime change has on the exit rates of all subsidiaries. More importantly, the schedules
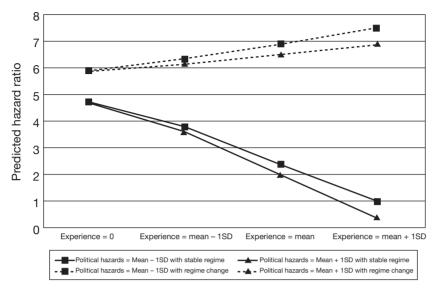
Figure 1 The tradeoff of experience

Note: Hazard ratios calculated at mean levels for all other variables for a subsidiary in an average region, industry and year

have inverted in slope, indicating that while experience still provides relative benefits with respect to political hazards (i.e. the schedule corresponding to high political hazards are everywhere below the schedule corresponding to low political hazards), more experienced firms have higher predicted exit rates after a regime change (H4b). After a regime change, instead of enjoying a performance benefit, firms with more experience under the political regime in power at the beginning of the year (i.e. the previous political regime) have higher predicted rates of exit. The same hypothetical firm with one standard deviation more than the mean level of experience that previously enjoyed a 59 (74)% reduction in predicted exit rates as compared with their counterparts at the mean (one standard deviation below the mean) level of experience now faces a 9 (19)% increase in predicted exit rates. The effect is moderated as political hazards increase but even when political hazards are one standard deviation above the mean, the 6 (13)% increase in predicted exit rates compares very unfavorably with the 82 (90)% reduction enjoyed in the absence of regime change.

Sensitivity analyses

We examined the sensitivity of our results to several alternative theoretical explanations and distributional assumptions about hazard rates across time. First, we examined several definitions of the inter-organizational environment so as to ensure that our definition of a peer group at the level of the industry was not driving our results. We divided all Japanese firms into large and small firm cohorts in which size was defined by sales, assets or employees. We found

consistent evidence of imitation in samples of both large and small firms, although the effects were much stronger among large firms. In a similar way, we found consistent evidence of greater imitation among older firms in samples divided into old and young firm cohorts. The effects of organizational experience (both positive and negative) were strongest for smaller, although not necessarily younger, firms.

Next, we examined if the experience measures proxied for the resource buffering effect of firm size or diversification that would minimize the impact of uncertainty (Thompson, 1967). Interactions of 'political hazards' and 'regime change' with indicator variables for horizontal or vertical group membership and employment and sales proxies for firm size failed to generate statistically significant coefficient estimates or to change the results in our base specification.

Following the literature on culture and subsidiary performance (Barkema et al., 1996), we added measures of cultural uncertainty and interacted these with measures of peer group and own firm experience in the same cultural block. These additions did not alter our results.

Prior studies have found links between corporate performance and exit rates using such proxies as a firm's return-on-sales or return-on-assets, but the inclusion of these variables did not improve the fit of our model. Similarly, multiple proxies for a country's cost of capital (Anderson and Tushman, 2001) did not improve model fit. We examined the role of tax policies at the aggregate level and found a positive association between the rate of capital taxation and subsidiary exit in the reduced sample of country-years for which tax data were available. Once again, the results of theoretical interest were unchanged. We introduced additional macroeconomic data into the specification. When we included the change in the real effective exchange rate, the growth in real per-head income, the growth in population, the percentage of value-added from manufacturing, the government budget balance and the government debt to GDP ratio, the results did not change substantively. Finally, our results were qualitatively unchanged across various hazard functions including the Cox proportional hazards model, a Weibull distribution and a Gamma distribution.

Discussion

We investigated the phenomenon of subsidiary exit in international expansions. As these expansions were made across clearly-defined national borders, we were able to test for the influence of a particular type of environmental uncertainty, emanating from differences in national political structures, on subsidiary exit rates. Although we observed no direct influence of the level of political hazards on exit rates, we did find that changes in political hazards had a direct effect on exit rates and that the levels of political hazards and regime change differentially affected exit rates depending on a firm's peers' prior exit decisions as well as the level and type of a firm's own prior experience in a host country.

A considerable body of research on organizations has examined the efficacy of various firm strategies for managing types of environmental uncertainty. But even with the prominent role ascribed to political change and political processes in organizational survival (Haveman et al., 2001; Ranger-Moore, 1997), research on organizations has only recently started to exploit the natural variation in the political environment in an international setting (Guillén, 2002; Henisz and Delios, 2001; Martin et al., 1998). Our results build on the body of research on international strategy for managing the political or non-market dimension of that environment. In doing so, we concentrated on two interpretations for the performance benefit of experience: one is an information-based rationale which argues that information accumulated through experience allows for improved forecasts of and reactions to changes in the policy environment, while the other is an influence-based rationale which argues that influence accumulated through experience allows firms to alter the future policy environment or generates the perception that they possess such influence.

We broached the question of whether the benefits of experience in the context of multinational firms' performance in foreign markets derive from information or influence by examining a firm's reactions to two sources of uncertainty in the political environment. First, we observed that under a stable political regime subsidiaries exhibit differential rates of exit depending on both the informational signals provided by prior peer exits which enhance the probability of exit, and the level and type of experience that they possess under that political regime which reduces the probability of exit. This result for experience in stable political regimes fails to separately identify the two causal mechanisms by which experience might alter performance. Specifically, if the structure of a host country's political institutions lends a wide range of discretion to policymakers, a firm's experience in that institutional structure may, akin to the observation that its peers are not exiting, help provide it with useful information that can aid in interpreting policy outcomes, or it can help generate actual or perceived influence. In either case, experience can improve performance.

By contrast, where political institutions themselves are subject to discontinuous change, information continues to provide useful inputs that can reduce variability in the forecast of the future policy environment, whereas actual influence depreciates rapidly and perceived influence may elicit a backlash. The same resources that aided the development of an influence strategy that were important assets in the past can now be transformed into substantial liabilities. In the aftermath of political regime change, an inexperienced organization can be at an advantage relative to its experienced counterparts because it faces a single hurdle in overcoming uncertainty about the new environment. However, an experienced counterpart faces a double hurdle of gaining information about the new environment, while trying to slough off resources and influence strategies developed for the old environment and reduce perceived associations of influence with the old environment.

Overall, the strategic implications of our results are that firms with relevant experience develop actual or perceived influence over a political regime and may, as a result, enjoy a short-term advantage over their less experienced counterparts. That gain, however, needs to be balanced against the long-term costs of maladaptation to, or retribution by, economic and political actors in succeeding regimes. The choice of political risk management strategies depends on managers' prior beliefs regarding the stability of the current regime. Where political hazards are high but the regime appears inherently stable, building strong ties to the existing regime as a step in the implementation of an influence strategy enhances performance. In the mid-2000s, such countries where that strategy could be a fruitful one are Singapore and China, each of which has not seen a regime change in decades, but which have a high level of political hazards. Meanwhile, where political hazards coincide with regime instability, such as in Pakistan and Indonesia, a more fluid strategy of developing weak informational ties to a political regime, or even looking to alternative sources of information such as the actions of peer firms, will avoid the costs of perceived or real associations with a past regime.

Limitations and future research

Like research that has identified how the home business context can exert substantial influences on a firm's international expansion decisions (Guillén, 2002), we considered only the case of home-country competitors. In the international environment, other firms from the home country are among the most likely to be observed (Martin et al., 1998) and imitated. In focusing on organizational experience, we did not consider firm-specific resources, entry mode choice (Lu, 2002), subsidiary characteristics or the identity of joint venture partners as influences on exit rates given environmental uncertainty. An analysis of these endogenous choices would necessitate a two-stage selection model that separates the effects of a firm's characteristics and its external environment on the strategy choice from their impact on exit rates (Shaver, 1998).

We encountered some difficulty in testing for the contingent effect of prior peer exits across countries with different levels of political hazards. We also found intriguing results using subsample analysis, suggesting that while peer exits are useful sources of information in countries with sufficient policy uncertainty, peer exits provide little or no informational signal for exit decisions in a wide range of countries with well-developed institutional structures. At one level, this result is intuitive, as it highlights the shortage of reliable information in countries characterized by institutional voids (Khanna, 2000). But this result does highlight the need for qualitative or quantitative analysis of the different strategies that firms employ to develop information in countries with substantive policy uncertainty compared with those with more predictable policy-making institutions. If prior peer exits are too coarse a metric in many countries,

what additional objective criteria do managers (and can researchers) identify to evaluate the sustainability of a firm's operations in a given country?

Conclusion

We use variation in national political environments to demonstrate that organizations rely upon both the information provided by peer behavior and upon their own organizational experience to manage political hazards and regime change. We call attention to the role of the actual or perceived influence, as opposed to the information, possessed by experienced firms, by demonstrating that firms with experience enjoy lower exit rates in politically hazardous environments, but these same firms are at a disadvantage in the event of a change in the political regime. These results show that experience leads to influence that is specific to the political regime in which the experience was garnered, but it becomes a liability after a regime change.

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Note

1   The data and additional detail on its construction can be downloaded from http://www-management.wharton.upenn.edu/henisz/

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