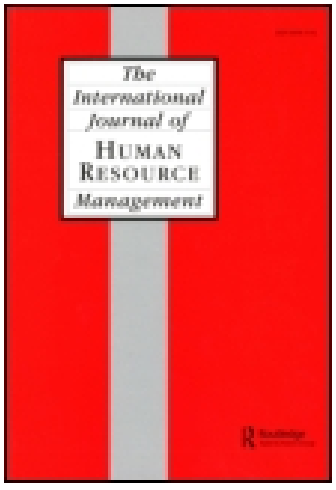

The International Journal of Human Resource Management

Publication details, including instructions for authors and subscription information:
http://www.tandfonline.com/loi/rijh20

Impact of nationality composition in foreign subsidiary on its performance: a case of Korean companies

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Published online: 21 Aug 2014.

To cite this article: Hea-Jung Hyun, Chang Hoon Oh & Yongsun Paik (2015) Impact of nationality composition in foreign subsidiary on its performance: a case of Korean companies, The International Journal of Human Resource Management, 26:6, 806-830, DOI: 10.1080/09585192.2014.949819

To link to this article: http://dx.doi.org/10.1080/09585192.2014.949819

The International Journal of Human Resource Management, 2015
Vol. 26, No. 6, 806–830, http://dx.doi.org/10.1080/09585192.2014.949819

Impact of nationality composition in foreign subsidiary on its performance: a case of Korean companies

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This study explores how the nationality compositions of management teams and employee groups in foreign subsidiaries can affect subsidiary performance. By analyzing firm-level data on 401 South Korean subsidiaries across 35 countries in the period between 2005 and 2007, we found that balanced compositions in both subsidiary management teams (SMTs) and subsidiary employee groups (SEGs) were positively associated with subsidiary performance. The results suggest that the benefits of balanced composition are higher for both innovative and coordinative tasks conducted by management teams and for simple computational tasks conducted by employee groups. The effect of the SMT and SEG compositions on subsidiary performance, however, may depend on the host country's institutional conditions. These findings have practical implications for multinational staffing strategies in order to ensure high performance in subsidiaries and for host country policies used to attract high quality foreign direct investments.

Keywords: expatriate; nationality; performance; subsidiary human resource management; workforce composition

Introduction

The existing literature on international business recognizes three distinctive competitive strategies: multinational corporations (MNCs) can exercise global, multi-domestic and transnational strategies (Bartlett & Ghoshal, 1998; Luo, 2001; Prahalad & Doz, 1987). A global strategy focuses on the need to integrate and coordinate operations around the world to achieve cost reductions through economies of scale and scope by developing highly standardized products and marketing approaches. MNCs integrate business activities worldwide in order to capture and benefit from linkages and synergies among countries, thereby gaining a competitive advantage (Vance & Paik, 2010). However, attempts to implement standardized policies and operational procedures worldwide across all international operating units may completely disregard the special needs of individual subsidiaries, including the different regulations in the nations in which they are located. In order to effectively deal with these differences, MNCs adopt a multi-domestic strategy that emphasizes local responsiveness. Finally, a transnational strategy seeks to extract the benefits of both global and multi-domestic strategies by locating the optimal trade-off between cost reduction and differentiation and, at the same time, achieve worldwide innovation and global learning through effective knowledge management (Bartlett & Beamish, 2011).

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The adoption of appropriate human resource management approaches is crucial to successfully implementing different strategic orientations of MNCs (Paik & Ando, 2011; Tarique, Schuler, & Gong, 2006). Parent country national managers (PCNMs) and host country national managers (HCNMs) are equipped with different types of competences and capabilities (Delios & Björkman, 2000; Edström & Galbraith, 1977; Harzing, 2001a, 2001b; Widmier, Brouthers, & Beamish, 2008) and MNCs will make appropriate staffing decisions depending upon the different circumstances that demand the capability of either PCNMs or HCNMs (Bonache, Brewster, & Suutari, 2001; Harzing, 2001a, 2001b; Tan & Mahoney, 2006). Thus, in this paper, we ask what are the appropriate nationality compositions for staffing decisions of both a subsidiary management team (SMT) and a subsidiary employee group (SEG) with regard to subsidiary performance. We also ask whether host country institutional quality places an additional layer in analyzing the nationality composition decision and performance.

PCNMs are considered more suitable for enhancing an MNC's control over foreign affiliates. It is because they not only easily accept headquarter-determined rules but also show strong commitment to overall corporate goals and priorities (Doz & Prahalad, 1986; Kobrin, 1988). PCNMs can replicate existing organizational specificities and the operating procedures of the headquarters in their local units (Rosenzweig & Singh, 1991). Furthermore, the assignment of PCNMs facilitates the creation of an information network where corporate culture is embedded as they can learn functional behaviors congruent with corporate goals more easily than local managers (Bartlett & Ghoshal, 1998). Therefore, PCNMS are preferred when MNCs pursue a global strategy that requires a higher level of control over foreign subsidiaries.

In contrast, HCNMs are considered more suitable in taking care of local responsiveness needs rather than headquarters' controlling overseas subsidiaries. As they possess in-depth local knowledge, HCNMs are more capable of addressing local idiosyncrasies associated with the cultural, economic, political and legal environments of a host country (Harzing, 2001a; Kobrin, 1988). HCNMs are also more effective in communicating with local employees and implementing local business practices as they are familiar with local demand conditions and cultural preferences (Harzing, 2001a; Sekiguchi, Bebenroth, & Li, 2011). Thus, MNCs are willing to allow more autonomy to HCNMs so that they can adapt the strategies of the headquarters to fit the specificity of the local situations. As HCNMs may better serve to address local responsiveness needs, they are preferred when MNCs pursue a multi-domestic or localization strategy (Gong, 2003; Tan & Mahoney, 2006; Vance & Paik, 2010).

Yet, most MNCs now pursue a transnational strategy, calling for a geocentric or regiocentric staffing approach that simultaneously meets the challenges of global/regional integration and local responsiveness. According to Bartlett and Beamish (2011), the purpose of a transnational strategy is threefold. First, a transnational strategy can achieve global efficiency by developing regional or worldwide cost advantages and standardizations in products and processes. Second, the company is able to become locally responsive with regard to meeting the demands of different regions' market structures, consumer preferences, and political and legal systems. Third, transnational strategy is expected to encourage organizational learning by transferring knowledge and spreading innovations across borders throughout the various parts of the company (Snow, Snell, Davison, & Hambrick, 1996). This transferring implies that a more balanced or diverse mix of PCNMs and HCNMs is desirable in order to effectively meet these multiple challenges facing MNCs.

An increasingly balanced or diversified workforce presents management teams with both opportunities and challenges. In this paper, we use balanced and diverse interchangeably because a balanced workforce consists of more PCNs, which does not exceed the number of HCNs. Managing a transnational workforce is increasingly important as businesses rely on cross-border interactions and operations. A long and active stream of research on the effects of diversity has documented its positive and negative effects. These findings have shown that, although diversity has led to improved decision-making and more creative problem-solving methods, it has also increased coordination and control costs by reducing interpersonal linkages, psychological commitments, intergroup communications and group cohesion (Lau & Murnighan, 2005). However, the literature in strategic human resource management has heavily focused on the role of PCNMs and HCNMs in top management teams (TMTs) as a driver of strategic innovation (Barkema & Shvyrkov, 2007).

At the subsidiary level, both PCNs and HCNs in the workforce may also provide benefits necessary for successful performance (Edström & Galbraith, 1977; Harzing, 2001a; Lam & Yeung, 2010). The synergy has been emphasized between locally embedded tacit knowledge and MNC-level non-location-bound firm-specific advantages (FSAs) (Rugman & Verbeke, 2001). This synergetic combination can provide unique subsidiary-specific advantages when compared to conventional MNC-level FSAs. The combination of both PCNs and HCNs (i.e. a balanced workforce rooted in different experiences in terms of nationality, tenure, education, age, etc.) promotes constructive debates and strategic innovations in the form of technological and administrative innovations, entry into new product markets and superior team performance (Bantel & Jackson, 1989; Boeker, 1997; Hambrick, Cho, & Chen, 1996; Wiersema & Bantel, 1992). Organizational researchers who have recognized the heterogeneous nature of the workforce have increasingly focused on the dynamics of teams made up of or containing multinational and multicultural members (e.g. Argote & McGrath, 1993; Jackson & Associates, 1992; Jackson, May, & Whitney, 1995; Lawrence, 1997; Snow et al., 1996).

Conversely, many organizations have interpreted diversity as a human resource cost to be managed instead of a human resource asset to be fostered. A team may subdivide depending on the situation and, thus, weak fault lines are likely to occur within the team (Lau & Murnighan, 1998). Unfortunately, as some studies have not shown that diversity positively impacts the bottom line, many top managers are not likely to see its value (Robinson & Dechant, 1997; Wright, Ferris, Hiller, & Kroll, 1995).

The purpose of this study is to investigate the influence of the nationality composition of the subsidiary workforce on subsidiary performance and find when and how the balanced composition turns into benefits or costs depending on the host country characteristics. In order to better understand the effects of nationality composition at the subsidiary level, we analyze 401 South Korean subsidiaries across 35 countries in the period between 2005 and 2007. In this study, we divide the subsidiary workforce into SMT and SEG. We measure the nationality composition of the SMT and SEG based on the portion of the PCNMs of the total number of managers and the parent country national employees (PCNEs) of the total number of employees, respectively.

This study offers unique contributions to the literature. First, while the existing literature in strategic human resource management focuses on the TMT or SMT, this study simultaneously looks at both management teams and employee groups. Second, we analyze the effects of nationality composition at the subsidiary level instead of at the headquarters level. Third, we investigate how host country institutional quality measured

by various indices moderates the effects of nationality composition on subsidiary performance.

Theory and literature

Little research has been conducted on nationality composition and performance at the SEG level except by a few scholars, such as Gong (2003) and Colakoglu and Caligiuri (2008). Since they analyzed nationality composition at the subsidiary workforce as a whole level, we were unable to gain much insight into nationality composition in SEG from the literature. However, TMT, transnational team and subsidiary staffing research provided us with important theoretical foundations for the effects of the nationality composition of SMT and SEG on subsidiary performance.

Nationality in workforce composition

Team member characteristics substantially influence the emergence of a shared team culture in two ways. First, team members' individual characteristics create their expectations of interaction rules, team efficacy beliefs and team identity. Second, these individual characteristics have an impact on team members' expectations of how others should behave within the team. In other words, an individual's demographic background determines her or his self-perceptions as a team member and assessments of the behavior of others within the team (Earley & Mosakowski, 2000; Markus & Kitayama, 1991).

Although several constructs, such as race, gender, religion, education and profession, may be available for considering the orientations of individuals from different backgrounds, nationality has several key advantages. While conventionally a simple and powerful construct, nationality is open to various definitions and operationalizations. Nationality is a superordinate determinant of a person's self-identity, derived through a meaning system shared with others (Earley & Mosakowski, 2000; Shweder & Levine, 1984). Therefore, nationality has meta-effects on individuals' trait hierarchies (Turner, 1985). That is, a person's nationality shapes the content and overall structure of a person's trait hierarchy. In transnational teams, nationality is the primary status determining trait (Hughes, 1971) and all other traits, such as race, gender, religion and profession, are secondary determinants (Gong, 2006; Hambrick, Davison, Snell, & Snow, 1998; Salk & Shenkar, 2001).

Nationality shapes a person in numerous interconnected ways, ranging from the deeply underlying to the readily apparent: values, cognitive schema, demeanor and language. These nationality-derived characteristics likely influence a person's behavior and how the person is perceived in a multinational team (Hambrick et al., 1998). Nationality often determines communication patterns and interaction styles (Geringer, 1988; Oetzel, 1995). Therefore, nationality-derived characteristics may serve as resources for teams, as well as create great difficulties when characteristics conflict.

Nationality is likely to be the most salient measure of workforce composition. In fact, the MNC subsidiary staffing literature has purely focused on nationality composition (e.g. Belderbos & Heijltjes, 2005; Harzing, 2001a, 2001b; Paik & Sohn, 2004; Sekiguchi et al., 2011; Tan & Mahoney, 2006) and its impact on performance (e.g. Fang, Jiang, Makino, & Beamish, 2010; Gaur, Delios, & Singh, 2007; Gong, 2003, 2006; Lam & Yeung, 2010). In this paper, our definition of nationality is the country in which an individual spent the majority of her or his formative years. Each individual carries substantial traces of nationality in his or her psychological make-up and behavior (Hambrick et al., 1998).

In this regard, Laurent (1983) found that even seasoned and internationally oriented executives exhibited major nationality-based differences in their beliefs about how to manage effectively.

The issue of nationality becomes even more significant for MNCs when they try to adequately meet legitimacy requirements. MNCs need to make themselves appear more local by increasing the ratio of HCNs within the local subsidiary workforce (Ando & Paik, 2013). HCNs are likely to view PCNs as salient social referents because they tend to be perceived as a salient out-group category on the basis of nationality (Paik, Parboteeah, & Shim, 2007; Toh & Denisi, 2003). As several nationalities tend to interact within the MNCs, national identities become naturally more relevant, often invoking an 'us versus them' mentality among HCNs.

Benefits of balanced nationality composition

Balanced nationality creates hybrid team cultures over time (e.g. Hambrick et al., 1998). Diverse or balanced nationality in human capital behaves as a source of sustained competitive advantage as far as it adds value that is both difficult to imitate and rare. Tremendous potential exists for a firm to exploit the rare characteristics of a diverse workforce base in order to create a competitive advantage (Kirchmeyer & McLellan, 1991; Richard, 2000). Diverse and balanced human resources, when properly coordinated and controlled, are protected by knowledge barriers and appear socially complex because the resources involve a combination of talents and backgrounds that are elusive and hard to identify (Lippman & Rumelt, 1982). Indeed, the value generated from diversity is hardly imitable (Tan & Mahoney, 2006).

Salutary effects from diversity have been hypothesized and observed in the literature. Different points of view in decision-making and problem-solving styles stimulate better decisions and non-obvious alternatives through the operation of a wider range of perspectives and a more thorough critical analysis of the issues (Jackson, 1992; McGrath, 1984; Nemeth, 1992; Shaw, 1981). In particular, when subgroups are well balanced within a group, the opinion of each subgroup will be properly valued and assessed. Thus, the knowledge transfer across subgroups is promoted. Using archival and field data, previous research has found that diverse TMTs improve decision-making quality and organizational performance (Bantel & Jackson, 1989; Camelo-Ordaz, Hernandez-Lara, & Valle-Cabrera, 2005; Cohen & Levinthal, 1990; Hambrick et al., 1996) and diverse SMTs or using PCNMs improve subsidiary performance (Chang, Gong, & Peng, 2012; Gong, 2003, 2006). Therefore, diverse or balanced nationality within decision-making teams may lead to changes in corporate strategy or organizational flexibility that may be advantageous in a particular market context (Amason, 1996).

Costs of balanced nationality composition

Alternatively, a number of studies have found that diverse or balanced team compositions have negative effects on team performance (e.g. Ancona & Caldwell, 1992; Tuckman, 1965). Lau and Murnighan's (1998, 2005) fault line model suggested that, when groups split (formally or informally) into subgroups, the members' group-related identities are more associated with their subgroups than the main groups. Members of groups with strong fault lines are likely to assume that their characteristics, such as scripts, values and assumptions, are similar to their fellow subgroup members' characteristics. In contrast, members of groups with weak fault lines are likely to focus more on their groups as a

whole and assume that they are broadly similar to their fellow group members. This description suggests that individuals' group-related identities are likely to have different sources in strong and weak fault line groups.

Sub-divided groups are more difficult and expensive to coordinate and control than homogeneous groups, and these added costs may impede performance. Team diversity (or heterogeneity) is negatively related to social integration and communication (Chua, 2013). Wiersema and Bantel (1992) stated that the unfamiliar language of other team members with dissimilar experiences, backgrounds, beliefs and values will apparently generate difficulties and costs in communication and diminished team integration. Demographic diversity decreases social contacts and, therefore, reduces social integration. O'Reilly, Caldwell, and Barnett (1989) argued that demographic dissimilarity decreases communication frequency within a group, therefore reducing group cohesion. At the subsidiary level, PCNMs are more expensive and cannot efficiently develop relationships with the front-line workforce as can HCNMs, thus HCNMs foster better cooperation and morale in the subsidiary workforce (Lam & Yeung, 2010). Therefore, a balanced and diverse team weakens team effectiveness and performance.

Hypotheses development

As our theoretical foundation of this paper, we adopt an eclectic approach that combines resource-based view (RBV) and upper echelons theory. MNCs increasingly recognize the effective management of human resources as a major determinant of success in the global market. The RBV (e.g. Barney, 1991) supports that acquisition and management of capable human resources are critical in creating a sustainable competitive advantage for MNCs. Diversity in an organization is more likely to achieve this goal as it enables an MNC to take advantage of the talent and skills of different groups of people. More specifically, as Hambrick and Mason (1984) argue, top management demographic characteristics such as diversity at the top management level will influence the decisions they make, and therefore the actions adopted by the organizations they lead and thus ultimately organizational performance. We will explain below how diversity at SMT contributes to improving coordination as well as facilitating knowledge transfer between headquarters and foreign subsidiaries.

Nationality composition in SMTs and SEGs

A subsidiary workforce may consist of home country, host country and third country nationals, but the portion of the third country nationals may be negligible, at least in the case of the subsidiaries of Korean MNCs. Therefore, in this study, we mainly focus our nationality composition on PCNs and HCNs. The SMT at the subsidiary is mainly expected to play both coordinative and innovative roles. First, the SMT needs to balance the demands of the local customers, employees and government officials with those of the headquarter managers (Roth & Nigh, 1992). This coordinative role requires a maximum ease of communication and reliability of interaction in order to be performed successfully (e.g. Hambrick et al., 1998). The balanced SMT will improve communication and interactions, not only within the SMT, but also with local stakeholders. Although we understand that PCNs typically have more decision-making power than HCNs, the RBV mainly focuses on the different types of resources each group will bring to an organization and assume that both groups can make an equal contribution to improving the performance of the subsidiary. Thus, more balance between the PCNs and HCNs in the SMT enables

the subsidiary to work more effectively with the MNC headquarters and local stakeholders.

Second, the innovative role of the SMT also requires balanced nationality. At the subsidiary level, nationality-based diversity enables the SMT to facilitate the transfer of knowledge and resources from the parent firm by PCNMs and gain knowledge about the local culture, customers, suppliers, institutions and business practices by HCNMs (Harzing, 2001a; Tan & Mahoney, 2006). The synergetic knowledge attained from the parent firms and host countries in the SMT will provide a non-location-specific subsidiary advantage (Rugman & Verbeke, 2001). The diversity of skills and outlook characteristics of SMTs can increase the adaptability of their subsidiaries and, thus, improve subsidiary performance.

Recognizing the distinctive traits of PCNMs and HCNMs, previous studies have examined the foreign subsidiary staffing practices of MNCs and their impact on performance. In explaining specific staffing practices of foreign subsidiaries, the studies adopted multiple theoretical perspectives that include agency theory (Gong, 2003), transaction cost theory (Bonache-Perez & Pla-Barber, 2005), institutional theory (Gaur et al., 2007) and knowledge-based view (Colakoglu, Tarique, & Caligiuri, 2009; Fang et al., 2010; Sekiguchi et al., 2011). However, previous research has reported contradictory results regarding the impact of foreign subsidiary staffing on subsidiary performance. For example, using data collected from Japanese firms, Gong (2003) found a positive impact of PCN assignment at the senior management, general manager and workforce levels on subsidiary performance. In contrast, using the institutional theory framework, Gaur et al. (2007) found a negative impact of PCN assignment on subsidiary performance at the total workforce level. Gaur et al. (2007) argued that a higher level of dependence on PCNs tends to decrease the legitimacy of foreign subsidiaries based on the data collected from Japanese firms. Likewise, Fang et al. (2010) found a negative relationship between the ratio of PCN in the total workforce and subsidiary performance. Yet, Colakoglu and Caligiuri (2008) did not discover any significant influence of PCN assignment at the workforce level on subsidiary performance in the study of U.S. firms. Sekiguchi et al. (2011) did not find a valid relationship between the PCNMs and subsidiary performance of Japanese firms.

Such inconsistent findings from the existing research suggest that our eclectic approach may provide a more appropriate theoretical foundation as the optimal staffing policy for foreign subsidiaries would be to seek a diverse or more balanced composition between PCNMs and HCNMs in order to discover the benefits of both. PCNMs mainly serve the need for control and knowledge transfers from headquarters to overseas subsidiaries. As the MNC headquarters expects its foreign subsidiaries to act in accordance with the company's overall interests, PCNMs can provide MNCs with a useful mechanism by which to enhance the headquarters' control over foreign operations. Using their capacity as an extension of the headquarters' reach into the foreign operations, PCNMs play a key role as a liaison between the headquarters and foreign subsidiaries, with the important responsibilities of the headquarters' strategy implementation, performance goal achievements and with increasing MNCs' control in the foreign operation (Paik & Sohn, 2004).

Similarly, Lam and Yeung (2010) contended that PCNMs resolve agency problems that may occur between the parent firm and foreign subsidiaries, but an excessive use of PCNMs causes difficulty in the firm's adaptation to local environments. PCNMs also play a critical role in transferring and disseminating a company's critical knowledge from the headquarters to foreign subsidiaries (Fang et al., 2010). However, HCNMs can help MNCs re-contextualize the knowledge to be transferred in the host country as they are more capable of addressing local idiosyncrasies associated with the cultural, economic, political

and legal environments of a host country. Using their knowledge of and experience with local demand conditions, HCNMs can effectively communicate with host country national employees (HCNEs) and implement business practices in accordance with the local context. Indeed, Chang et al. (2012) found that PCNM's competencies in knowledge transfer lead superior subsidiary performance, and the received knowledge also increases subsidiary performance when the subsidiary has better absorptive capacity. In addition, MNCs can expect better treatment from a host country government when they use more HCNMs than PCNMs in management positions in their overseas subsidiaries. Demonstrating confidence in the local managers as well as a commitment to develop local talent can positively influence local perceptions about the MNC and, thus, increase local legitimacy.

A balanced staffing arrangement will also better serve the goal of the headquarters' transnational strategy by transforming the individual overseas experiences and acquired knowledge of the expatriates into organizational learning at the collective level. PCNMs and HCNMs can work together to build knowledge processing and training infrastructures that help institutionalize new knowledge so that it flows back and forth between the corporate headquarters and foreign subsidiaries (Vance, Paik, & Chow, 2011).

Therefore, the following hypothesis is posited.

Hypothesis 1: A balanced composition between PCNMs and HCNMs is associated with higher subsidiary performance.

A staffing practice that influences employee groups may have different implications for the subsidiary than a staffing practice concerning the key managerial positions of a foreign subsidiary (Ando & Paik, 2013). In contrast to the coordinative and innovative tasks, such as strategic control and knowledge transfer conducted by PCNMs, PCNEs are mainly engaged in knowledge sharing with HCNEs for simple and computational tasks. To effectively transfer knowledge to HCNEs, it is critical to build a strong partnership with local employees and gain their trust. Firms without a capacity to extract the potential and develop the ability of local employees may struggle to overcome their liability of foreignness. Therefore, local legitimacy becomes a more paramount concern than control at the employee level. In order to adequately meet legitimacy requirements, MNCs need to portray and promote a more local company image (Ando & Paik, 2013). The localization of the workforce improves the MNC's acceptability and resultant legitimacy within the local context (Kostova & Zaheer, 1999; Xu, Pan, & Beamish, 2004). In addition, the lower ratio of PCNEs tends to increase the morale of HCNEs as the latter may reduce the potential resentment against the former arising from the compensation gap in the SEG. Gaur et al. (2007) contended that too high a proportion of PCNs in the workforce can reduce subsidiary legitimacy and performance. Similarly, Konopaske, Werner, and Neupert (2002) and Fang et al. (2010) found that PCN assignments at the workforce level were negatively associated with subsidiary performance.

Therefore, the following hypothesis is posited.

Hypothesis 2: A lower ratio of PCNEs relative to HCNEs is associated with higher subsidiary performance.

Role of host country institutional quality

Formal and informal institutions establish the 'rules of the game' and structure economic, legal and political relationships in a country (North, 1990). In turn, these institutions affect

the quality of governance, overall environment of business, attractiveness of a particular market to foreign firms and behavior of foreign firms (Oh & Oetzel, 2011; Slagen & Beugelsdijk, 2010). Thus, a host country's institutional quality, such as property right protection, effective rules and regulations, stable government policies and low levels of corruption, is expected to affect the business practices of multinational enterprises in the country. In a similar vein, Hambrick (2007) encourages examining the effect of macro-social context in TMT research.

Management teams have the task of formulating and implementing the firms' strategies (Hambrick & Mason, 1984) and, as part of their leadership function, must coordinate and control the teams' behaviors. PCNs in the SMT (i.e. PCNMs in general) implement the firm's strategy in a host country and coordinate the activities between the headquarters and subsidiaries. When a host country has a low institutional quality, on one hand, HCNMs in the SMT tend to show rent-seeking behaviors for their own benefits. Therefore, in order to align the subsidiary strategy with the headquarters' strategy and monitor and control the HCNMs, the SMT may need more PCNMs. Thus, bureaucratic control by the PCNMs will replace the absence or weakness of institutional quality in the host country.

On the other hand, when the host country has high institutional quality, monitoring can be effective with a small number of PCNMs in the SMT. A subsidiary needs little supervision when its managers share its goals and strategies for achievement. As all members in a SMT have a thorough understanding of how the organization operates, costs of communication and coordination are reduced. If the organization's own norms and values are well established, then introducing outsiders with different values will reduce efficiency (Murray, 1989). Hierarchical control by the PCNMs will make a subsidiary less responsive to changes in the local competitive environment. The increased bureaucracy necessary to monitor and control a subsidiary may adversely affect an organization's performance. Therefore, the following hypothesis is posited.

Hypothesis 3: Host country institutional quality moderates the relationship between the composition of the subsidiary management team and subsidiary performance, such that, as the institutional quality increases, the effect of the balanced composition of the SMT on subsidiary performance becomes less positive.

The primary responsibility of PCNEs is not controlling their subsidiaries to implement parent company strategies. Their tasks are more likely to focus on skill-oriented and computational tasks through specialization. Thus, a balanced composition of a SEG will improve knowledge transfer and sharing within a SEG rather than generate conflicts when the host country provides a business friendly environment. In a country with high institutional quality, knowledge and technology, which are transferred and shared within an MNC and its subsidiary, are likely secured in the host country. Therefore, such favorable institutional conditions likely reduce the opportunistic behavior of the subsidiary workforce and improve knowledge transfer and sharing (e.g. Lu, Tsang, & Peng, 2008). This will encourage the headquarters to assign value added activities to a subsidiary that will eventually improve subsidiary performance.

In contrast, in a country with low institutional quality, innovative activities within a subsidiary will be hampered due to appropriability and imitation (e.g. Maskus, 2000). Accordingly, MNCs will assign low value added mechanical activities to the subsidiary in its value chains. Thus, the subsidiary will be dominated by HCNEs due to a lower need for knowledge transfer from the headquarters, reducing international staffing costs and

implementations. Little or low knowledge spillover eventually decreases the efficiency, creativity and performance of subsidiaries. In addition, a low level of institutional quality will raise the legitimacy issue, and make it more difficult to meet legitimacy requirements (Judge, Douglas, & Kutan, 2008). Thus, MNCs increase the ratio of HCNEs relative to subsidiary employees to increase productivity in a host country with low institutional quality. Therefore, the following hypothesis is posited.

Hypothesis 4: Host country institutional quality moderates the relationship between the composition of SEGs and subsidiary performance, such that, as the institutional quality increases, the effect of the balanced composition of SEGs on subsidiary performance becomes more positive.

Research design

Our aim is to set forth a general, parsimonious model that will help to explain a considerable amount of variance in the effectiveness of workforce composition. Due to the nested nature of our data (i.e. subsidiaries within a country), we used a random effect multilevel regression model (hierarchical linear model). The multilevel model allowed us to estimate the random effects that vary by host country (De Clercq, Lim, & Oh, 2013). We also used heteroskedasticity and autocorrelation robust standard errors clustered by host country.

This study relies on firm-level data from Korean manufacturing MNCs. In the data, the definition of MNC is a firm that made equity investments in foreign countries. The data on the activities of 401 foreign subsidiaries were drawn from the Export–Import Bank of Korea (EXIM). The raw data contained 790 subsidiaries for the period between 2005 and 2007. Of these subsidiaries, 401 subsidiaries submitted reports containing information on affiliate activities in all the 3 years. After the data cleaning process by pairwise deletion for the missing information in the survey data, 927 observations of 401 subsidiaries between 2005 and 2007 are left. This dataset includes detailed information on Korean subsidiaries in foreign countries, such as destination and financial performance for the 3-year period from 2005 to 2007.

For our dependent variable, we used the subsidiary labor productivity as measured by total sales divided by the number of subsidiary employees (Gaur et al., 2007; Gong, 2003; Richard, 2000). Because our study focuses on workforce staffing decision in subsidiaries, labor productivity is an appropriate measure of subsidiary performance (Gaur et al., 2007). Two of our independent variables are the nationality compositions in SMT and SEG that are measured by the ratios of PCNs in the SMT and SEG, respectively (e.g. Gong, 2003). We separated the nationality composition of the workforce into SMT and SEG compositions. Our data showed that the portion of HCNs in both the SMT and SEG were always larger than those of the PCNs. The average ratio of PCNs in the subsidiaries of Korean MNCs was 0.24 in SMT and 0.06 in SEG. These values are lower than those of Japanese MNCs, but close to European MNCs (Harzing, 2001a). When the SMT or SEG is more evenly balanced between PCNs and HCNs, then the index has a maximum value of 0.5.

Another independent variable that we used was institutional quality, which was taken from the Property Right Protection Index in the Economic Freedom Index by the Heritage Foundation (2013). Several academic studies have used this index in order to compare institutional quality and development across countries and analyze their impact on productivity, economic growth or entrepreneurial activities (e.g. Acemoglu & Johnson,

2005; Barseghyan, 2008; Mcmullen, Bagby, & Palich, 2008). As a robustness check, we used several indices in the International Country Risk Guide, which reports the various types of country institutional quality indexes. We used the law and order, bureaucracy quality and (control of) corruption as proxies of institutional quality. In order to construct interaction terms between institutional quality and workforce diversity, we used mean-centered variables.

We included a set of parent-, subsidiary- and country-level control variables. We used the size of the parent firm (i.e. log of sales) in order to control the parent-level characteristics (Delios & Beamish, 2001). We expect that subsidiaries whose parent firms are large will perform better because of better shared resource pools and economies of scale (Chung & Beamish, 2005). The subsidiary-level control variables used were subsidiary size, subsidiary age and entry mode. These variables tended to have a direct effect on performance (e.g. Gaur et al., 2007; Gong, 2003; Richard, 2000; Tihanyi, Ellstrand, Daily, & Dalton, 2000). We measured the subsidiary size as logarithmic transformations of the total number of people employed at the subsidiary. The subsidiary age was measured by a logarithmic transformation of the number of years of operation in the host country. The entry mode was a dummy variable, which equaled 1 when the entry mode was M&A and 0 when the entry mode was a greenfield investment. Expected from existing studies (Fang et al., 2010), subsidiary size and age have positive effects on performance due to economies of scale and experiential knowledge in the host market. We also expect M&A entry mode will have a positive performance implication compared to a greenfield investment because the subsidiary can use accumulated knowledge of partnering or acquiring firms (Chang & Chang, 2012).

The country-level control variables used were market size (i.e. the log of the real GDP), country size (i.e. the log of the population) and geographic and cultural distances between Korea and the host country following a standard gravity model design. The real GDP and population were taken from the World Development Indicators, while the geographic distance was extracted from the Centre d'Etudes Prospectives et d'Informations Internationales. We used Kogut and Singh's (1988) national cultural distance to calculate the cultural distance based on Hofstede's cultural dimension (Gaur et al., 2007; Gong, 2003). We expect that subsidiaries perform better in larger and culturally and geographically close host countries (Fang et al., 2010; Gaur et al., 2007).

In addition, we added industry fixed effects in order to control for unobserved industry heteroskedasticity. We used a three-digit Korea Standard Industry code for the main industry sector of a subsidiary. Although the main industry sectors of parent firms are manufacturing, their subsidiaries can be operating in service industry sectors. Hambrick and Mason (1984) suggested that the occurrence of a particular set of backgrounds on behalf of a manager in a firm is not a random process. Managers in an industry share similar backgrounds. We provided the host country list in Appendix 1.

Research findings

Table 1 provides descriptive statistics and correlations for each of the variables in our study. The correlation matrix does not show any symptoms of multicollinearity. As a diagnostic procedure for our sample and the variables, the average variance inflation factors were less than 3.34 and the highest individual variance inflation factor was 8.14. These values are less than the cut-off point of 10 (Neter, Kutner, Nachtscheim, & Wasserman, 1996). An analysis of the residuals revealed no consequential departures from normality assumption. Based on the z-scores, no significant outliers were detected.

Table 1. Descriptive statistics and correlation matrix.

Variable	*Mean*	*SD*	*1*	*2*	*3*	*4*	*5*	*6*	*7*	*8*	*9*	*10*	*11*	*12*	*13*	*14*
1. Subsidiary performance	5.05	2.24														
2. Nationality comp. in SMT	0.24	0.27	0.13													
3. Nationality comp. in SEG	0.06	0.16	0.35	0.33												
4. Parent size	27.18	2.48	0.59	−0.08	0.13											
5. Subsidiary size	10.34	2.06	0.71	−0.09	0.09	0.65										
6. Subsidiary age	1.40	1.85	0.31	0.05	0.06	0.17	0.38									
7. Entry mode	0.05	0.22	0.08	−0.03	−0.05	0.01	−0.02	0.05								
8. GDP	27.78	1.51	0.11	0.16	0.13	−0.16	−0.09	0.00	−0.12							
9. Population	19.57	1.62	−0.51	−0.05	−0.18	−0.43	−0.24	−0.11	−0.43	0.60						
10. Geographic distance	7.67	0.72	0.40	0.06	0.11	0.28	0.18	0.14	0.33	−0.09	−0.57					
11. Cultural distance	8.23	3.60	0.25	0.17	0.19	−0.04	−0.04	−0.01	0.01	0.60	0.09	0.16				
12. Property right protection	0.50	0.31	0.67	0.19	0.32	0.32	0.37	0.16	0.12	0.24	−0.59	0.67	0.47			
13. Law and order	0.64	0.16	0.37	0.14	0.19	0.07	−0.05	0.09	0.07	0.55	0.04	0.03	0.62	0.44		
14. Bureaucracy quality	0.52	0.28	0.62	0.25	0.35	0.27	0.16	0.11	0.32	0.29	−0.52	0.60	0.49	0.92	0.58	
15. (Control of) corruption	0.32	0.22	0.62	0.21	0.31	0.28	0.13	0.13	0.33	0.20	−0.56	0.65	0.58	0.89	0.89	0.49

Notes: $N = 927$. Correlations in deemed lettering indicate variables that do not enter a model together.

Table 2 presents the results of the hierarchical regression analyses for foreign subsidiary performance. Model 1 tests only the effects of the control variables on subsidiary performance. Model 2 tests the effects of nationality composition in SMT and SEG on subsidiary performance in order to test Hypotheses 1 and 2. Model 3 includes the interaction terms between nationality composition and institutional quality (property right protection) in order to test Hypotheses 3 and 4. The log-likelihood tests show that adding two diversity variables and their interactions with institutional quality significantly increases the model fit ($p < 0.000$).

Model 1 of Table 2 shows that parent firm size, subsidiary size and subsidiary age are positively associated with subsidiary performance. In addition, host country market size (i.e. the log of the GDP) and population significantly determine subsidiary performance. The country institutional quality itself does not have a significant impact on subsidiary performance. Somewhat surprisingly, geographic and cultural distances do not significantly affect performance, yet the effects are negative. We presume that these distances affect the subsidiary entry process and strategies rather than subsidiary performance.

The results in Model 2 show that the coefficient of the SMT composition is positive and significant ($\beta = 0.268$; $p < 0.05$) and the coefficient of the SMG composition is positive and significant ($\beta = 1.613$; $p < 0.01$). The results support Hypothesis 1, but reject Hypothesis 2. It is also important to note that the coefficient of the SEG composition

Table 2. Subsidiary workforce diversity and subsidiary performance.

	(1)	*(2)*	*(3)*
Nationality composition in SMT (NCSMT)		0.268** (0.112)	0.280** (0.111)
Nationality composition in SEG (NCSEG)		1.613*** (0.203)	1.049*** (0.237)
NCSMT × property rights protection			0.813** (0.326)
NCSEG × property rights protection			2.518*** (0.661)
Log of parent size	0.053*** (0.018)	0.054*** (0.017)	0.048*** (0.017)
Log of subsidiary size	0.485*** (0.023)	0.489*** (0.022)	0.494*** (0.021)
Log of subsidiary age	0.062*** (0.018)	0.060*** (0.018)	0.054*** (0.017)
Entry mode	0.155 (0.149)	0.195 (0.143)	0.254* (0.142)
Log of GDP	0.594*** (0.113)	0.554*** (0.108)	0.546*** (0.105)
Log of population	−0.722*** (0.125)	−0.691*** (0.118)	−0.705*** (0.115)
Log of geographic distance	−0.184 (0.134)	−0.150 (0.126)	−0.138 (0.122)
Cultural distance	−0.012 (0.020)	−0.015 (0.019)	−0.013 (0.018)
Property rights protection	0.149 (0.535)	0.062 (0.509)	0.062 (0.497)
Constant	−2.023 (2.154)	−1.953 (2.032)	−1.477 (1.968)
Log likelihood	−1189.28	−1152.57	−1139.86
Observations	927	927	927
Number of groups	35	35	35
Random effects (host country)	0.164** (0.067)	0.144** (0.058)	0.131** (0.053)
LR test against linear regression model	48.25*** ($p < 0.000$)	48.37*** ($p < 0.000$)	48.37*** ($p < 0.000$)
LR test against model (1)		82.02*** ($p < 0.000$)	108.58*** ($p < 0.000$)

Notes: Robust standard errors are in parentheses. ***, ** and * indicate statistical significance at 1%, 5% and 10%, respectively. Industry and year fixed effects are included but are not reported.

is statistically significantly higher than that of the SMT composition ($\chi^2 = 28.32$; $p < 0.01$).

The results in Model 3 show that the interaction term between the SMT composition and institutional quality is positive and significant ($\beta = 0.813$; $p < 0.05$) and the interaction term between the SEG composition and institutional quality is positive and significant ($\beta = 2.518$; $p < 0.01$). These results suggest that there are positive moderation effects of the quality of the host country institution on the relationship between the nationality composition of the SMT and subsidiary performance as well as on the linkage between the nationality composition of the SEG and performance. The results provide strong support for Hypothesis 4, but not for Hypothesis 3.

As discussed above, we tested the robustness of our results by using three other measures of country governance: law and order, bureaucracy quality and (control of) corruption. Law and order measures the strength and impartiality of the judicial system and the observance of the law. Low points are given to countries where the law is routinely ignored without effective sanction and the crime rate is very high. Bureaucracy quality measures the institutional strength and quality of the bureaucracy, which may minimize revisions of policy when governments change. High points are given to countries where the bureaucracy has the strength and expertise to govern without drastic changes in policy or interruptions in governmental services. Corruption measures actual or potential corruption in the form of financial corruption, excessive patronage, nepotism, job reservations, 'favor-for-favors', secret party funding and suspiciously close ties between politics and business. High points are given to countries where corruption is low. These robustness checks provided consistent results. (Refer to Table 3 for more information.) Both nationality compositions in the SMT and SEG are positive and significant, and their interactions with institutional quality are positive and significant.

Because existing studies often found opposite results from ours (i.e. negative effects of PCNs on performance), we tested curvilinear models by including squared terms of the nationality composition in the SMT and SEG. The results show that the curvilinear relationship is insignificant for the SMT, while the potential of an inverted-U-shaped relationship is found (the squared term of nationality composition in SEG is negative and significant) for the SEG. However, when we plot the curvilinear effects of nationality composition in the SEG, within the range of the data points, the slope is still positive with a decreasing rate. Thus, the results do not show significant differences between the linear and inverted-U relationships. Due to the parsimonious principle in econometrics, we report the results from the linear model for our main findings.

Discussion and conclusions

Discussion of results

The purpose of this study was to analyze the relationship between nationality composition and subsidiary performance, and to investigate whether host country institutional quality can be a conduit through which this relationship can be either reinforced or attenuated. We classified subsidiary workforce composition into SMT and SEG compositions. The results demonstrated that balanced composition in both SMT and SEG improves subsidiary performance measured by labor productivity. These results suggested that the benefits of balanced composition are higher for the monitoring, coordinative, and innovative tasks conducted by the SMT and for the simple computational tasks conducted by the SEG. Our findings confirmed the previous results that TMT diversity has been

Table 3. Robustness check: subsidiary workforce diversity and subsidiary performance.

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
Nationality composition in SMT (NCSMT)		0.268**	0.268**		0.269**	0.267**		0.268**	0.252**
		(0.112)	(0.111)		(0.112)	(0.111)		(0.112)	(0.110)
Nationality composition in SEG (NCSEG)		1.612***	1.410***		1.615***	1.190***		1.616***	1.089***
		(0.203)	(0.219)		(0.203)	(0.235)		(0.204)	(0.224)
NCSMT × law and order			2.314***						
			(0.722)						
NCSEG × law and order			2.951**						
			(1.496)						
NCSMT × bureaucracy quality						0.878**			
						(0.369)			
NCSEG × bureaucracy quality						1.993***			
						(0.661)			
NCSMT × corruption									1.292***
									(0.458)
NCSEG × corruption									3.194***
									(0.764)
Log of parent size	0.053***	0.054***	0.051***	0.053***	0.054***	0.051***	0.053***	0.054***	(0.017)
	(0.018)	(0.017)	(0.017)	(0.018)	(0.018)	(0.017)	(0.018)	(0.018)	
Log of subsidiary size	0.485***	0.489***	0.492***	0.484***	0.489***	0.490***	0.485***	0.489***	0.495***
	(0.022)	(0.022)	(0.022)	(0.023)	(0.022)	(0.029)	(0.023)	(0.022)	(0.022)
Log of subsidiary age	0.062***	0.060***	0.057***	0.062***	0.060***	0.056***	0.063***	0.060***	0.052***
	(0.018)	(0.017)	(0.018)	(0.019)	(0.018)	(0.018)	(0.019)	(0.018)	(0.018)
Entry mode	0.153	0.195	0.202	0.151	0.192	0.238*	0.154	0.194	0.271*
	(0.149)	(0.143)	(0.142)	(0.149)	(0.143)	(0.142)	(0.149)	(0.143)	(0.141)
Log of GDP	0.575***	0.531***	0.528***	0.634***	0.593***	0.575***	0.602***	0.570***	0.577***
	(0.099)	(0.0941)	(0.093)	(0.106)	(0.099)	(0.099)	(0.092)	(0.088)	(0.084)
Log of population	−0.706***	−0.669***	−0.678***	−0.764***	−0.729***	−0.733***	−0.731***	−0.708***	−0.745***
	(0.106)	(0.0995)	(0.098)	(0.109)	(0.102)	(0.102)	(0.102)	(0.097)	(0.093)
Log of geographic distance	−0.167	−0.139	−0.127	−0.177	−0.145	−0.124	−0.183	−0.145	−0.145
	(0.132)	(0.124)	(0.122)	(0.133)	(0.124)	(0.124)	(0.132)	(0.125)	(0.120)

(*Continued*)

Table 3 – *continued*

	(1)	*(2)*	*(3)*	*(4)*	*(5)*	*(6)*	*(7)*	*(8)*	*(9)*
Cultural distance	−0.014	−0.0177	−0.016	−0.009	−0.011	−0.010	−0.013	−0.015	−0.010
	(0.020)	(0.0191)	(0.019)	(0.022)	(0.021)	(0.021)	(0.020)	(0.019)	(0.018)
Law and order	0.360	0.284	0.422						
	(0.520)	(0.491)	(0.484)						
Bureaucracy quality				−0.144	−0.239	−0.210			
				(0.539)	(0.506)	(0.505)			
Corruption							0.122	−0.057	−0.223
							(0.403)	(0.385)	(0.377)
Constant				−2.250	−2.191	−1.768	−2.063	−2.035	−1.408
				(2.183)	(2.039)	(2.038)	(2.125)	(2.007)	(1.926)
Log likelihood	−1189.11	−1152.44	−1140.44	−1189.11	−1152.47	−1142.85	−1189.56	−1152.84	−1134.59
Observations	927	927	927	927	927	927	927	927	927
Number of groups	35	35	35	35	35	35	35	35	35
Random effects (host country)	0.424***	0.375***	0.367***	0.412***	0.381***	0.382***	0.040***	0.379***	0.300***
	(0.084)	(0.077)	(0.075)	(0.084)	(0.077)	(0.076)	(0.082)	(0.076)	(0.073)
LR test	38.49***	42.49***	44.75***	49.82***	49.80***	54.04***	48.89***	55.43***	53.78***
Against linear regression model	($p < 0.000$)	($p < 0.000$)	($p < 0.000$)	($p < 0.000$)	($p < 0.000$)	($p < 0.000$)	($p < 0.000$)	($p < 0.000$)	($p < 0.000$)

Notes: Robust standard errors are in parentheses. ***, ** and * indicate statistical significance at 1%, 5% and 10%, respectively. Industry and year fixed effects are included but are not reported.

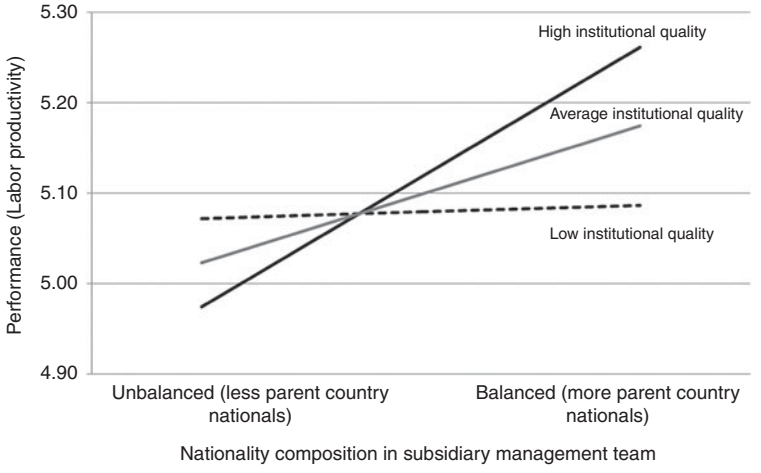
associated with organizational innovation (e.g. Barkema & Shvyrkov, 2007; Camelo-Ordaz et al., 2005; Kirchmeyer & McLellan, 1991). We presumed that although the monitoring and supervising roles of PCNs in the SMT could be a source of conflict in SMTs similar to the existence of the fault line in TMT, benefits from balancing PCNs and HCNs can outweigh costs in implementing control through integration and coordination, and knowledge transfer and sharing between the company's headquarters and its subsidiaries. Thus PCNs enhance knowledge transfer from headquarters to subsidiaries (Fang et al., 2010; Sekiguchi et al., 2011). This means that subsidiary performance will improve when MNCs take advantage of combining different perspectives between PCNMs and HCNMs (Chang et al., 2012; Gong, 2003, 2006). If the subsidiary is predominated either by PCNMs or HCNMs, this dominance will result in unilateral perspectives, driven by either home country or host country mindsets. Instead, a balanced composition in SMTs can help MNCs develop a broader global perspective by bringing together different mind-sets between the two groups of managers.

Unlike our expectations, our results showed that diverse or balanced nationality composition in SEGs improves the performance of the subsidiary. We presumed that although a legitimacy concern is likely to occur in SEG and localization of the workforce may improve local acceptability, the benefits of knowledge sharing more than offset the legitimacy concern. The knowledge sharing within a SEG is required in order to transfer corporate knowledge about technical skills, such as production, sales, financing and procurement, as well as local knowledge about these skills (Colakoglu & Caligiuri, 2008; Gong, 2003). Knowledge sharing occurs through both formal and informal channels. The formal channel includes training and mentoring, but may be insufficient for organizations to solely rely on the formal channel. Organizations must also consider informal social interactions of the person-to-person channel. Thus, PCNEs help to socialize HCNEs into their corporate culture. In this way, HCNEs learn tacit and corporate-specific knowledge and skills through daily interactions with PCNEs (Luo & Peng, 1999). Few PCNEs may be able to manage training and mentoring programs in subsidiaries, but more PCNEs are required to achieve intimate daily interactions between PCNEs and HCNEs.

Our findings regarding the moderating effects of country institutional quality shed further light on these results. When the quality of the host country's institution is high, then the relationship between the balanced compositions in SMT and subsidiary performance becomes more positive (Figure 1). Likewise, as the host country institutional quality increases, the effects of the balanced composition of SEG on subsidiary performance become more positive (Figure 2). Thus institutions serve as a source of knowledge, resources and innovation (Lu et al., 2008).

In order to test whether the slope of a regression line in each of figures is significantly different from zero, we performed simple slope tests (Aiken & West, 1991). The simple slope tests confirm the positive regression of subsidiary performance on balanced nationality composition at the high- and average-level of institutional quality. When institutional quality is low, the effect of balanced nationality composition on subsidiary performance is not different from zero.

The research results lead us to believe that on the one hand, when a host country has low institutional quality, controlling and coordinating diverse management teams often generate conflict because of the lack of formal rules and regulations in the resolution process. Such conflicts will lower the efficient transfer of knowledge and strategic organizational practices between PCNs and HCNs. In particular, less transparent conflict resolution processes can make the legitimacy issue more profound than control or knowledge transfer issues. Thus Lau and Murnighan's fault line model (1998, 2005) can



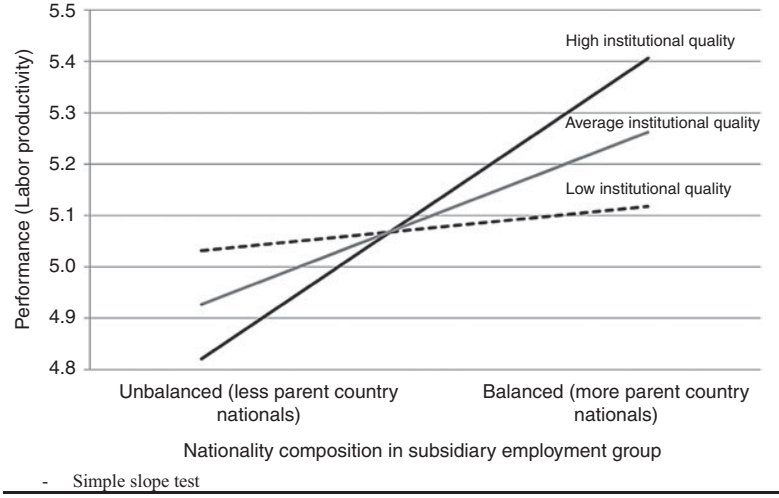
- Simple slope test

	Simple slope	Standard error	t-test
High institutional quality	0.532	0.140	3.810***
Average institutional quality	0.280	0.105	2.664***
Low institutional quality	0.028	0.148	0.189

***, **, and * indicate statistical significance at 1%, 5%, and 10% respectively.

Figure 1. Interaction graphs for nationality composition in SMT and host country institutional quality on subsidiary performance.

be applied to organizations operating in countries with low institutional quality. On the other hand, when the host country has high institutional quality, legitimacy issues can be solved with formal and impartial resolution processes (e.g. Judge et al., 2008; Li,



- Simple slope test

	Simple slope	Standard error	t-test
High institutional quality	1.829	0.206	8.892***
Average institutional quality	1.049	0.247	4.247***
Low institutional quality	0.268	0.399	0.067

***, **, and * indicate statistical significance at 1%, 5%, and 10% respectively.

Figure 2. Interaction graphs for nationality composition in SEG and country institutional quality on subsidiary performance.

Bingham, & Umphress, 2007). In addition, reliance on formal rules and procedures can establish the institutionalization of trust in an organization (Sitkin, 1995). Therefore, a subsidiary can focus more effectively on control and knowledge transfer and, thus, increase productivity. As all workforce members at the subsidiary have a thorough understanding of how the organization operates, costs of communication and coordination are reduced. Thus, the results suggest that when host country institutional quality is high, MNCs tend to assign more PCNs to SMTs and SEGs in order to improve performance. High institutional quality will lower the communication and coordination costs in a balanced workforce, thus improving subsidiary performance. This finding is consistent with previous studies that underline the role of nationality in deciding communication patterns and interaction styles (Geringer, 1988; Oetzel, 1995). In addition, in a host country with high institutional quality, subsidiaries may have better absorptive capacity, and firm-specific knowledge and property rights are more likely to be protected (Chang et al., 2012). In such an environment, foreign subsidiaries have incentives to increase PCNs to assign additional value-added tasks.

Limitations, future research and implications

We acknowledge that this study's empirical approach is not without limitations. The data come from secondary sources, so we cannot capture the process-based and cognitive dynamics that underlie the hypothesized relationships – that is, the organizational processes by which the composition of a subsidiary workforce influences organizational capability or group conflict – or how these processes may be moderated by country institutional quality. Additional research might use personal interviews with subsidiary managers and employees to capture and measure subsidiary-level mechanisms that facilitate or hamper the full exploitation of PCNs and HCNs to improve subsidiary performance.

In addition, we only examined a single demographic attribute (i.e. nationality), which may cause analysts to miss the potential impact of other attributes or their interactions. These attributes include tenure, education, age, gender and career background (Barkema & Shvyrkov, 2007). Demographic diversity was suggested to have a greater influence on social processes, sometimes negatively as with stereotyping, distrust and emotional conflict, than on task-related debates (Chua, 2013; Jehn, 1997). Additional analysis of other subsidiary-level (i.e. entry mode, age and size) and country-level (i.e. cultural distance and income disparity) contingencies also may be important in the impact of subsidiary workforce composition on performance.

Future research might also consider industry differences and turbulent country environments (Richard, 2000). For example, given the importance of cultural sensitivity in services, service and financial firms tend to benefit more from HCNs than manufacturing firms. Turbulent environments likely intervene in the local adaptation strategy of the MNC or stabilize its performance in a host country. Therefore, workforce composition itself may have a dynamic capability due to its ability to make creative decisions and have flexibility to adapt to turbulent environments. Thus, a balanced workforce could be a subsidiary's specific advantage under certain conditions.

In addition, a longitudinal analysis should shed additional light on this topic. PCNs and HCNs will likely learn each other's culture and business practices and build a trust relationship. Over time a subsidiary will develop its unique subsidiary-specific institutional environment, nationality itself would not be an important issue in staffing over the time of operation. Therefore, formal and informal host country institutional

characteristics will likely lose their importance. Due to the short observation period, our study focuses on cross-country differences and cannot reveal this dynamic. Future research may focus on this dynamic by using longer time period data.

Despite these limitations, this study offers important research as well as practical implications. The findings of this study advance our knowledge about the theoretical application of upper echelons theory and the RBV to the issue of diversity in making staffing decisions on MNCs' foreign subsidiaries. Although the upper echelons theory recognizes the benefits of diversity at the top management level, its theoretical framework has not been applied to the context of international human resource management. By regarding both PCNs and HCNs as critical resources with distinctive competences that MNCs can exploit to achieve a long-term sustainable competitiveness, we were able to overcome the limitations of agency theory or a transactions cost approach that mainly treats the relationship between PCNs and HCNs as mutually exclusive by focusing on either the opportunistic behaviors of HCNs or the bureaucratic costs involved in using PCNs. The research findings suggest that the RBV and upper echelons theory provide a more appropriate and comprehensive theoretical framework for investigating issues related to international human resource management such as diversity, expatriates and global talent management.

The research results also offer the following practical implications. First and foremost, given the positive effect of diversity on subsidiary performance, MNCs need to put more effort to achieve a balanced ratio between PCNs and HCNs at both the top and lower levels of the organizational hierarchy. Consistent with upper echelons theory argument, diversity at the SMT is likely to breed diversity at SEGs, as the demographic diversity that is represented in upper echelons tends to have a positive impact on the issues related to diversity throughout the whole organization. Increased diversity at SMT will help MNCs implement global talent management as they are more likely to attract and retain whoever is deemed to have the knowledge and skills required to perform an assigned job (Gelfand, Nishii, Raver, & Schneider, 2004). Building diversity within the organization is also consistent with the RBV that emphasizes the development of inimitable resources, i.e. intangible (human) capital to sustain competitive advantage (Hambrick & Mason, 1984; Kirchmeyer & McLellan, 1991; Richard, 2000). To tap into the talent of HCNs, MNCs need to keep track of and develop potential skills of HCNs through the establishment of a database on the subsidiary employees.

Second, although MNCs may reduce the risk of opportunistic behaviors by using PCNs in foreign countries, the legitimacy issue of HCNs still exists, particularly when the institutional quality of the host country is weak (Judge et al., 2008). As MNCs cannot expect much benefit from diversity in such circumstances, they should not fill managerial positions at foreign subsidiaries with many expatriates since the predominant use of PCNs is not likely to improve the subsidiaries' performance. Such an ethnocentric staffing policy will increase the resentments of HCNs and make communication between expatriates and local managers difficult and inefficient. Conversely, in a host country with high institutional quality, MNCs should seek diversity more aggressively so that they can maximize the benefits from knowledge and best management practices transfer from headquarters to foreign subsidiaries.

Third, MNCs should carefully evaluate the level of institutional quality before making a decision on whether to enter the foreign market or not. MNCs do not likely transfer their valuable activities and best management practices to their foreign subsidiaries unless a host country provides a favorable institutional environment. For example, inadequate protection of intellectual property rights (IPRs) will discourage MNCs from placing

HCNMs at the SMT for fear of losing critical firm-specific knowledge to local managers who might take it with them when they leave the company to join a competitor. According to Reuters (2011), U.S. Commerce Secretary Gary Locke said China's opaque government regulations and poor enforcement of patents and other IPRs indirectly discourage U.S. foreign investment. By improving the country's institutional qualities, a host country can attract more quality-based foreign direct investments and entail an MNCs' value-added activities that will, eventually, improve national competitiveness.

In conclusion, this study is among the first to explain the effects of the nationality composition of subsidiary managers and employees together on subsidiary performance. In particular, this study investigated the contingency effect of host country institutional quality. Such attention is warranted due to the potency with which subsidiary workforce diversities enhance subsidiary performance, which may depend on the host country's institutional condition in which the workforce interactions take place. This study explained variations in the level of subsidiary performance across different institutional and geographic settings and, as such, may serve as a stepping stone toward a more comprehensive understanding of the country- and regional-level drivers of superior subsidiary performance in a given subsidiary workforce composition.

Acknowledgements

We acknowledge the constructive comments from the guest editor, Elaine Farndale, and four anonymous reviewers. Mila Lazarova provided helpful comments on an earlier version of this paper. The authors are listed in alphabetical order.

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Appendix 1

List of host countries.

Australia	Hungary	Mongolia	Portugal	Switzerland
Bangladesh	India	Myanmar	Russia	Taiwan
Canada	Indonesia	Netherlands	Singapore	Thailand
China	Italy	North Mariana	Slovakia	Turkey
France	Japan	Pakistan	Spain	United Kingdom
Germany	Malaysia	Philippines	Sri Lanka	United States
Hong Kong	Mexico	Poland	Sweden	Vietnam