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National Income Inequality and International Business Expansion

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National Income Inequality and International Business Expansion

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Keywords:	inequality, institutional theory, international business, multinational firms, business and society
Abstract:	<p>In this paper, we examine the extent to which host country income inequality influences multinational enterprises' (MNEs) expansion strategy for foreign production investment, depending on their specific strategic objectives. Applying a transaction cost framework, we predict that national income inequality has an inverted U-shaped relationship with foreign production investment. As inequality increases, MNEs accrue lower transaction costs arising from interactions with various local actors, leading to higher probability of investment. As income inequality increases further, its effect on location attractiveness will become negative, as its attraction effect is increasingly offset by additional monitoring, bargaining and security costs owing to the more fractious nature of high inequality societies. In addition, we suggest that the impact of income inequality is contingent on investment objectives: the inverted U-shaped relationship is stronger for efficiency-seeking investment but weaker for market-seeking and competence-enhancing investments. We find substantial support for our hypotheses through an analysis of 27 years (1986-2012) of data on Japanese MNEs' overseas production entries.</p>

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Author Biographical Information

Nathaniel C. Lupton (PhD, Western University) is an Associate Professor at the Dhillon School of Business at University of Lethbridge. His research interests include foreign direct investment strategy, international knowledge diffusion, and development economics. His ongoing research examines the determinants of national and international inequality and their relationship with economic development. His research has appeared in journals such as *Academy of Management Perspectives*, *Journal of Knowledge Management*, *Journal of World Business*, *Knowledge Management Research and Practice*, and others.

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Luis F. Escobar (PhD, University of Calgary) is an Assistant Professor at the Dhillon School of Business. His research interest focus on corporate sustainability, stakeholder engagement and collaboration strategies. His articles have appeared in journals such as *Administration & Society*, *Journal of Business Ethics*, and *Latin American Business Review*.

Dr. Alfredo Jimenez (PhD, University of Burgos) is an Associate Professor at the Kedge Business School (France). He has also been a visiting scholar in different institutions in Australia, Denmark, Ecuador, Germany, Italy, Mexico, Norway and Singapore. His research interests are focused on the process and the determinants of success in the internationalization strategy of firms including political risk, cultural and psychic distance and corruption. In addition, he is also working on research devoted to virtual team and multi-cultural team management and dynamics. He has previously published several papers in several international journals, including *International Business Review*, *Journal of International Business Studies*, *Journal of World Business* and *Management International Review*, and others.

Scholars have undertaken important steps toward understanding the causes and consequences of income inequality – the distribution of income within a given population – through the lenses of business, government, and societal interaction (Beal & Astakhova, 2017; Marens, 2018; Riaz, 2015). Inequality research, with its roots in sociology and political science, has revealed several negative impacts that income inequality has on individual and societal wellbeing (Neckerman & Torche, 2007). More recently, the relationship between inequality and organizational form, behavior, and survival has entered this discussion (Bapuji & Neville, 2015; Elmes, 2018; Wang, Zhao, & Thornhill, 2015). To further this discussion, we study the extent to which the anticipated costs of dealing with varying levels of inequality affect the likelihood that a location will be selected for investment by foreign firms.

Influenced by cultural norms, labor market conditions, and political forces, firms' wage-setting practices contribute to a nation's degree of national income inequality (Bapuji, Husted, Lu, & Mir, 2018). Organizational forms spawned by specific institutional configurations (e.g. public corporations) can in turn reinforce existing inequality (Davis, 2017; Pathak & Muralidharan, 2018). On the other hand, rising income inequality can trigger a variety of social movements that increase policy risks, thereby challenging firms' legitimacy and operational success (Bapuji & Neville, 2015; Reinecke, 2018). Our study builds upon this discussion through a theoretical and empirical examination of how multinational enterprises (MNEs) respond to host country income inequality while making major decisions about the internationalization of production investments.

Our study examines organizational response to inequality within the context of two core multinational business decisions: 1) How does national income inequality influence MNEs' choice among potential locations for offshore production? and 2) How do MNE investment

objectives (namely efficiency-seeking, market-seeking, or competence-enhancing) affect the degree of influence that income inequality has on location choice? Income inequality refers here to unevenness in the distribution of financial resources, primarily wage and household income, among a country's members (Ahlquist, 2017).

We argue that income inequality has both positive and negative implications for the MNE and that these vary by both the degree of inequality and the MNE's investment objective. Existing research has focused on the negative impacts of income inequality on individual wellbeing and societal functioning (Neckerman & Torche, 2007; Pickett & Wilkinson, 2015). For example, income inequality has been found to inhibit human development (Pickett & Wilkinson, 2007, 2015), damage trust (Uslaner & Brown, 2005), increase socio-political instability (Alesina & Perotti, 1996; Oishi & Kesebir, 2015), and contribute to political violence and crime (Jayadev & Bowles, 2006; Keefer & Knack, 2002). Conducting business in these fractious environments increases risk to firms, which, in turn, increases operating costs (Henisz, 2000).

While mitigating the threats arising from inequality could be costly, as inequality increases MNEs may also benefit from reduced need to bargain with unions, the state, and other civil society organizations (CSOs) (Beramendi & Rueda, 2014; Kourula & Laasonen, 2010). They also retain greater flexibility in using performance-based financial incentives (Katic & Ingram, 2018; Simpson, 2009). Therefore, increasing levels of inequality can result in a more attractive location for MNE investment. However, at higher levels of inequality, the added costs associated with political instability, damaged trust, and reduced access to education and health care offset the benefits of labor productivity and pay differences. We thus propose an inverted U-

shaped relationship in which location attractiveness increases with inequality at lower levels but decreases with higher levels of inequality.

We predict that the magnitude of benefits and costs attributable to income inequality will vary according to MNEs' economic objectives for a particular investment (Cantwell & Mudambi, 2005; Dunning, 2000). We argue that the relationship between a host country's income inequality and an MNE's location choice will be stronger in the case of an efficiency-seeking investment, and weaker in the case of market-seeking and competence-enhancing investments. To test our predictions, we used data on foreign subsidiaries established by Japanese firms, and we find robust empirical evidence supporting our hypotheses. Our sample includes nearly all production subsidiaries established by Japanese parent firms between 1986 and 2012, where information on investment motive was available. Japanese MNEs have been found to be a suitable basis for a great number of studies on internationalization and corporate strategy (Delios & Henisz, 2003; Head, Ries, & Swenson, 1995; Hennart & Park, 1994).

Understanding how national income inequality impacts international expansion decisions is essential to further examining the extent to which MNEs, the state, CSOs, and domestic competitors directly or indirectly influence income inequality (Audebrand & Barros, 2018; Marens, 2018). International business scholars have also emphasized that MNEs exercise strategic discretion when expanding overseas (Hutzschenreuter, Pedersen, & Volberda, 2007; Jiang, Holburn, & Beamish, forthcoming). Though income inequality is a relevant location attribute, the current literature offers limited guidance on how to address the case of the MNE that, by definition, operates in more than one society. We therefore aim in this article to contribute to the growing discussion on the relationship between inequality and the behavior of business, especially MNEs (Beal & Astakhova, 2017; Neckerman & Torche, 2007). We combine

the many findings from research on the institutional (i.e. government, civil society, and business) antecedents and consequences of income inequality (Bapuji, 2015), emphasizing organizations as cost-economizing institutions (Coase, 1937; Williamson, 1985). As foreign direct investment (FDI) involves substantial financial commitments, and produces long-term and far-reaching consequences for the MNE’s financial performance, social legitimacy, and survival (de Lange, Armanios, Delgado-Ceballos, & Sandhu, 2015), we view location choice as an appropriate context in which to investigate the revealed preferences of MNEs towards varying levels of income inequality.

Our study is motivated by the need to understand firms’ decisions and strategic responses to income inequality. As stated by Bapuji (2015): “...*organizational practitioners need to understand how inequality shapes their choices related to management and strategies*” (p. 1060). In answer to another call (Marens, 2018), we shed light on how inequality impacts managerial decisions, combining perspectives from international business research with business and society scholarship. We thus provide both a unique empirical study and a novel perspective on business and inequality research, by demonstrating the existence of a type of institutional arbitrage that maximizes the economic benefits of multinationalism while reducing frictions in rent extraction caused by local inequality. While a host of factors are involved in these location decisions, the extent to which MNEs vote for locations through provisioning large capital investments has the potential to shape not only their own functioning, but also the societies in which they invest.

Theory and Hypotheses

Research on inequality predominantly focuses on its institutional antecedents and consequences (Bapuji & Neville, 2015; Davis, 2017; Wadhwani, 2018). There are clear implications for

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3 inequality stemming from the existence and strength of labor unions, government regulation of
4 wages and working conditions, centralization of wage bargaining, and hiring and layoff policies
5 (Greckhamer, 2016; Wolff, 2015). These formal institutions affect the degree of inequality
6 within their respective realms of influence, but are also subject to pressures for change, in part
7 driven by the evolving trends in inequality. High and/or rising inequality erodes society-
8 regulating institutions consisting of trust, norms of cooperation, and civic responsibility (Amis,
9 Munir, & Mair, 2017; Khan, Munir, & Willmott, 2007). Inequality and institutional change thus
10 appear to be endogenous, co-evolutionary processes (Alamgir & Cairns, 2015; Beramendi &
11 Rueda, 2014).

12
13 Pressures for institutional change operate through CSOs, political processes, protest
14 movements, business lobbying, and other more radical manifestations of socio-political
15 instability, including crime and political violence (Jayadev & Bowles, 2006; Rodrik, 1999;
16 Shrivastava & Ivanova, 2015). While research has mainly considered firms to be exogenous to
17 the co-evolution of institutions and inequality, they are nonetheless primary providers of income
18 (Neckerman & Torche, 2007). There is evidence that the division of proceeds between owners of
19 capital and employees responds, systematically, to institutional conditions (Cobb, 2016). The
20 MNE is unique in its response to institutions, because it operates within a host of institutional
21 environments and contributes to the international division of labor. International business
22 research has established that the location of different value chain activities responds, in part, to
23 the quality of the institutional environment, including the degree of political risk and corruption,
24 and the social and infrastructure services provided by the state (Henisz, 2000, 2002; Hennart,
25 2009). Hence, MNEs have an opportunity to engage in institutional arbitrage, namely relocating
26 and internalizing value chain segments depending on host country institutions, to maximize

aggregate economic efficiency, global competitiveness, and ultimately return on investment (Jackson & Deeg, 2008).

The economic benefits accruing to the MNE, through internationalization, are to varying degrees offset by the incremental costs arising from frequent and complex interactions with labor unions, the state, buyers, suppliers, and CSOs (Cooke, 1997, 2001; Guo, Xu, & Jacobs, 2014; Kourula & Laasonen, 2010). Some of these costs (e.g. contract negotiation, monitoring, and enforcement costs) are incurred to mitigate ex-post opportunistic behaviors by transacting parties and have been well documented by international business scholars (Hennart, 1991). MNEs' foreign production investments are vulnerable to ex-post hold-up by the state and other stakeholders, due to long investment horizons and immobility of the assets invested (Jensen, 2006). MNEs incur substantial costs (e.g. complex contracts, renegotiation, lobbying) to mitigate hold-up threats and therefore tend to favor locations where these threats are lower (Oetzel, 2005). In the following, we consider the transaction cost implication of low and high inequality locations for production investment.

Low Inequality and Location Attractiveness

Economic coordination legislation enables a variety of labor and business stakeholders to participate in establishing wages, benefits, and working conditions. This coordination is more pervasive in countries that, historically, have had lower income inequality (Beramendi & Rueda, 2014). This is because in countries with higher inequality, high wage earners are less likely to support centralized economic coordination, as their existing economic privileges are at stake, and they typically have greater influence over political processes than lower income earners (Uslaner, 2008). Hence, the centralization of negotiating wage and working conditions is more

likely to gain traction among corporations in low inequality societies (Beramendi & Rueda, 2014). The threat of centralized economic coordination stems, in part, from the ability of workers to strike as a tactic in bargaining for higher wages. It also allows employees to engage collectively with the government to increase minimum wages, employment protections, and public benefits, which in turn are paid for through income and corporate taxes (Ahlquist, 2017; Western & Rosenfeld, 2011).

Furthermore, low inequality societies are generally more tolerant of social unrest, which enables social movements to influence individuals' perceptions of their upward economic mobility (Shariff, Wiwad, & Aknin, 2016). Cooperation among domestic firms is often legitimized by the demands of these social movements (Audebrand & Barros, 2018), which, in turn, makes domestic industry more competitive against corporate interests and foreign entry (Audebrand & Barros, 2018). Therefore, an institutional environment with low inequality implies the additional costs of engaging with domestic firms and institutional proponents of improved labor conditions and compensation. Negotiations will take longer, will be costlier, and will reduce the discretion of firms to adjust levels of employment (e.g. through layoffs, or temporary or part-time employment) and limit the range of options for providing performance-based incentives. Hence, as inequality increases, the economizing opportunities of the production subsidiary also increase.

High Inequality and Location Attractiveness

A growing body of literature suggests that high inequality stifles economic growth (Alesina & Perotti, 1996) and diminishes health across the income spectrum (Pickett & Wilkinson, 2015), resulting in increased workplace absenteeism (Andrews & Htun, 2018). High inequality also

limits access to education and health care, thereby entrenching inequality across multiple generations (OECD, 2015; Ostry, Berg, & Tsangarides, 2014; Pickett & Wilkinson, 2007). In addition, high inequality dampens trust and norms of civic cooperation (Uslaner & Brown, 2005). Since the efficiency of firms is impacted by the institutions that underpin economic activity and prosperity (North, 1987), the erosion of the institutional environment resulting from high inequality will reduce the efficiency of collecting payments, negotiating and reinforcing contracts, and monitoring employees and business partners. High inequality thus leads to higher contracting and operating costs for the MNE and increases expropriation risk, ultimately decreasing location attractiveness (2002; Knack & Keefer, 1997).

Instability produced by higher inequality may manifest in overt political actions including, in extreme cases, violence (Keefer & Knack, 2002; Oetzel, 2005). Political unrest and violence reduce the functioning of the formal institutions of the state, creating threats to the security of property and persons. Lower levels of trust in high inequality societies can also increase vandalism and violent crimes (Fowles & Merva, 1996; Jayadev & Bowles, 2006). MNEs are primary targets of these crimes because they are often viewed as perpetrators of inequality through alignment with the state and outcompeting local firms (Shrivastava & Ivanova, 2015). This fractious environment increases operating costs for the MNE, through additional monitoring and security expenditures to protect property and personnel (Rivera-Santos, Rufin, & Kolk, 2012). The World Bank’s “Enterprise Survey” reveals that “crime, theft and disorder” are widely cited threats to firms in the highest inequality countries (World Bank Group, 2018).

In summary, low inequality environments represent increased MNE operating costs due to the higher degree and/or threat of more centralized economic coordination, increased domestic

competition, and meeting the demands of CSOs. Hence, at low levels of inequality, the relationship between inequality and location attractiveness is positive, but we predict that the relationship reaches an inflection point at much higher levels of inequality. Beyond this inflection point, the added costs associated with political instability, damaged trust, and norms of civic cooperation begin to reduce location attractiveness. Based on our arguments that low and high levels of income inequality produce opposite effects on location attractiveness, we posit:

Hypothesis 1: The relationship between a host country's income inequality and the probability of MNE production entry into that country is an inverted U-shape.

Contingent Effects of Investment Objectives

MNEs' investment objectives influence how host countries' location advantages and disadvantages are evaluated (Hakkala et al., 2008; Makino, Lau, & Yeh, 2002). For instance, although a host country's political instability makes foreign investments less likely, the extent of the negative relationship between this and other factors (e.g., economic coordination, trust, cooperation) and location attractiveness is contingent on the objective of a specific investment (Brouthers, Gao, & McNicol, 2008; Hakkala et al., 2008). We likewise argue that the degree to which income inequality influences location choice will depend upon the investment objective. These contingent effects alter the costs of income inequality when interacting with workers, buyers, suppliers, government regulators, or CSOs. Where these interactions are of greater consequence to the economic objectives of a firm, the institutional environment should have a stronger effect on location attractiveness. We focus on three well-established investment

objectives: efficiency-seeking, market-seeking, and competence-enhancing (Cantwell & Mudambi, 2005).

Efficiency-seeking objective. One of the primary motivations for offshoring production is to increase efficiency through the division of labor and/or economies of scale (Dunning, 2000). While controlling cost is important in all types of overseas investments, efficiency-seeking investment especially focuses on reducing costs through increased labor productivity and/or reduced labor cost. As we will argue in subsequent sections, cost reduction is not necessarily a primary aim for competency-enhancing and market-seeking investments, for which the availability of skilled labor, political instability, and trust levels in society are more relevant.

Prior research shows that rising wage levels and worker protections motivate decisions to offshore production (Cooke, 2001; Harrison & McMillan, 2006). In lower inequality societies, where centralized bargaining is more prevalent, CSOs representing the interests of employees, customers, environmental protection, product and production standards, and so forth all tend to have more influence and a greater ability to both voice their concern and have their concerns addressed (Uslaner & Brown, 2005). As inequality increases, the threat of centralized bargaining and the influence of CSOs and other stakeholders diminish (Beramendi & Rueda, 2014). Thus, a production subsidiary has more leverage in setting wages according to the MNE's priorities. In the absence of more stringent worker protection policies, MNEs can more easily adjust wages and levels of employment in response to fluctuations in global demand. Therefore, the production subsidiary's cost-economizing opportunities arise from increased inequality and the accompanying reduced need both for economic coordination and to respond to CSOs' concerns, thereby creating a more conducive environment for the MNE to implement cost reduction in production subsidiaries.

Since cost economizing is a higher priority for efficiency-seeking subsidiaries than for competence- and market-seeking subsidiaries, even though the former will still be forced to cope with the heightened socio-political instability associated with high inequality, the increase in location attractiveness will be more pronounced. In other words, the inverted U-shape relationship proposed in H1 will exhibit a sharper ascent in location attractiveness as inequality increases, culminating in a higher inflection point. Thus, we expect a stronger inverted U-shaped relationship between income inequality and production entry in the case of efficiency-seeking subsidiaries, and posit:

Hypothesis 2: The relationship between a host country's income inequality and the probability of MNE production entry will strengthen when the new subsidiary has an efficiency-seeking mandate.

Competence-enhancing objective. Foreign subsidiaries are increasingly established to contribute to new value creation through product and technological development (Demirbag & Glaister, 2010). While cost economizing is the main driver of efficiency-seeking production investments, these competency-enhancing investments require the most suitable human resource qualities. Unlike an efficiency- or market-seeking mandate, these investments are focused on enhancing the MNE's competencies, rather than exploiting them (Cantwell & Mudambi, 2005). Competence-enhancing investment augments the MNE's capabilities by allowing it to tap into geographically dispersed knowledge (Andersson, Forsgren, & Holm, 2001; Chen, Chen, & Ku, 2004). Hence, the key considerations when choosing locations for MNE competence-enhancing

investments include access to knowledge workers, knowledge sharing and collaboration among employees, and the protection of intellectual property.

A nation's supply of knowledge workers depends significantly on its investment in education and the ability of graduates to find suitable employment. As income inequality increases, education becomes less obtainable as governments increasingly serve a narrower elite (Barnard, 2008; OECD, 2015). As a result, there is less availability of knowledge workers to staff competence-enhancing subsidiaries. Knowledge workers, being in greater demand as a result, have higher bargaining power in wage negotiations, increasing the MNE's talent search and retaining costs. Even when a subsidiary is able to initially source knowledge workers, high inequality locations are unlikely to continuously supply such workers over time. The reason for this is twofold: first, rising inequality leaves lower-income workers with costly options for improving their skills and education, thus they are less likely to make such investments (OECD, 2015). Second, children from lower-income families spend less time in education than their wealthier counterparts, therefore developing subpar numeracy and literacy skills, and limiting their career opportunities (OECD, 2013).

Subsidiaries with a competence-enhancing mandate must also create productive relationships with local sources of knowledge and pockets of expertise in both private and public institutions. In higher inequality societies, which are more prone to fractious socio-political environments (Alesina & Rodrik, 1994; Uslander, 2008) and low levels of trust among economic actors (Oishi & Kesebir, 2015), MNEs find it harder to become more socially embedded, inhibiting their ability to absorb local knowledge from research institutes and business partners (Heidenreich, 2012). These complications tend to hinder competency-seeking subsidiaries'

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3 efforts to create new knowledge and enhance their capabilities, thus lowering their return from
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5 invested assets.
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8 Finally, the greater need to protect MNEs' proprietary knowledge in higher inequality
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10 countries increases operating costs (Oxley, 1999). Higher levels of income inequality heighten
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12 the probability of political unrest, thus increasing the uncertainty surrounding the development of
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14 economic policies, the rule of law, and the protection of property rights (Alesina & Perotti, 1996;
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16 Easterly, Ritze, & Woolcock, 2006). Higher inequality is also associated with a greater
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18 propensity by enfranchised members of the population to hoard valuable assets (Persson &
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20 Tabellini, 1994). Conversely, disenfranchised subsidiary employees may be more motivated to
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22 share proprietary information with competitors for personal gains. While this increases the risk
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24 of MNE investments in general, it is more salient, and hence costlier, in the case of competence-
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26 enhancing subsidiaries.
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31 Significantly curtailing the potential benefits of efficiency gains, the increased costs
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33 (mitigating lack of trust, socio-political instability, and limited availability of knowledge
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35 workers) and risk (expropriation and proprietary knowledge leaking) associated with increased
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37 income inequality are more salient to investments with a competence-enhancing mandate than
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39 the other types of investment. We therefore expect a weaker inverted U-shaped relationship
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41 between income inequality and production entry, where there will be less increase in location
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43 attractiveness with increases in inequality, in turn resulting in a lower inflection point. Hence, we
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45 posit:
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Hypothesis 3: The relationship between a host country's income inequality and the probability of MNE production entry will attenuate when the new subsidiary has a competence-enhancing mandate.

Market-seeking objective. Market-seeking investment expands the MNE's customer base by exploiting firm-specific production assets, economies of scale, and market power (Dunning, 2000). Factors influencing the location choice for market-seeking investments include, first and foremost, the availability of large, affluent market segments and the level of economic development of the host country (Lei & Chen, 2011; Makino et al., 2002). Hence, increasing labor productivity and reducing labor cost become secondary objectives to new revenue generation.

As income inequality increases, social conflict in conjunction with socio-political instability often impedes economic development (Alesina & Perotti, 1996; Alesina & Rodrik, 1994; Oetzel, 2005). As a result, the diminished market potential significantly offsets potential economizing opportunities from higher income inequality (as in the case of efficiency-seeking subsidiaries), making the location less attractive for market-seeking investments (Rodrik, 1999). In addition to CSOs and employees, production subsidiaries with market-seeking mandates must engage closely with customers, suppliers, and distributors in the local economy, thus increasing the interfaces in which bargaining situations arise (Hakkala et al., 2008). In higher inequality environments, where it is more difficult to build trusting relationships with institutional actors, the market-seeking MNE needs to allocate more resources to building political connections to gain access to the local market (Boddewyn, 1994; Hillman & Hitt, 1999; Knack & Keefer, 1997). Hence, market-seeking subsidiaries are more vulnerable to socio-political instability.

Scholars argue that such instability could potentially result in overt political actions (Keefer & Knack, 2002; Oetzel, 2005), unrest, and violence (Fowles & Merva, 1996; Jayadev & Bowles, 2006), increasing the cost associated with safeguarding the subsidiary's assets and personnel (Rivera-Santos et al., 2012).

Furthermore, as inequality increases, so do shadow economies, which are comprised of unrecorded transactions for legal and illegal goods and services (Dell'Anno, 2016). Citizens are more willing to engage in shadow transactions to supplement their livelihood, reduce their taxable income, and increase their standard of living, as the formal institutional systems appear rigged against them (Uslaner & Brown, 2005). Given that shadow economies are not transparent, they are more difficult to understand and thus costlier to compete within, especially for MNEs, which tend to exhibit a liability of foreignness.

Limited market potential and socio-political instability associated with increasing income inequality are thus especially salient impediments to achieving the objectives of market-seeking subsidiaries, offsetting the benefits arising from labor cost economizing. We therefore expect a weaker relationship between income inequality and production entry in the case of market-seeking investment, where there will be a lower rate of increase in location attractiveness as inequality increases, culminating in a lower inflection point. Hence, we posit:

Hypothesis 4: The relationship between a host country's income inequality and the probability of MNE production entry will attenuate when the new subsidiary has a market-seeking mandate.

Method

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Data and Sample

To test our theoretical model, we used data compiled by Toyo Keizai in its annual publication, *Kaigai Shinshutsu Kigyō Souran (Japanese Overseas Investment)*. This database provides detailed information – including host country, industry classification, founding year, and parent firms – on nearly all foreign subsidiaries established by Japanese firms. It also provides unique information on investment objectives for individual subsidiaries. Our sample includes all production subsidiaries established by Japanese parent firms between 1986 and 2012. We use the 1986–2012 data period for two main reasons. First, Japan has been a leading source of outward FDI in the world following the signing of the Plaza Accord in September 1985 (Yamawaki, 2007). Second, we do not have comprehensive data on subsidiaries established in earlier years, which may result in bias towards subsidiaries that survived. In addition, the latest edition of the *Japanese Overseas Investment* obtained was published in 2012.

Dependent Variable

Our unit of analysis is a production entry to a potential host country in a given year. For each firm-year-country observation, the binary dependent variable – *Entry* – takes on the value of one when an MNE established a production subsidiary in the country, and the value of zero otherwise.

Independent Variables

The main independent variable, *Income Inequality*, is measured as the Gini index of inequality in equivalized household disposable income drawn from the Standardized World Income Inequality

Database (SWIID) version 5.0 (Solt, 2009). The SWIID combines information from a number of prevalent databases on income inequality, including the United Nations University World Income Inequality Database (WIID) and the Luxembourg Income Study data (LIS). As a result, the SWIID offers more country-year observations than any other income inequality dataset. Since its coverage and comparability far exceed those of the alternatives, the SWIID is considered best suited for international research on income inequality, compared to other sources (Solt, 2009).

We measure investment objectives using unique data on self-reported, subsidiary-specific investment objectives drawn from the *Japanese Overseas Investment* dataset. We selected investment objectives identified by the extant literature as manifesting underlying investment strategies to operationalize subsidiary strategic mandates (Caves, 2007; Dunning & Lundan, 2008). Four self-reported objectives are pertinent to efficiency-seeking investment: “access labor force” (*Efficiency-Seeking, Labor*), “development of overseas production network” (*Efficiency-Seeking, Production Network*), “export to third countries” (*Efficiency-Seeking, Export Others*), and “reverse imports to Japan” (*Efficiency-Seeking, Export Japan*). Investments motivated by these objectives allow the firm to gain efficiency through increasing specialization, economies of scale, and labor arbitrage (Dunning & Lundan, 2008). *Market-Seeking* is measured by one self-reported objective: “access local market”. *Competence-Enhancing* is measured by examining another objective: “development of products and planning”.

The objective variables are set at one when a specific objective is reported and zero otherwise. We record investment objectives reported in the first three years that each subsidiary appeared in the dataset, to capture the strategic mandates initially motivating the entry. Fifty-nine percent of production subsidiaries in the sample did not report any investment objectives. Since

missing information on investment objectives cannot be treated as absence of intent, we exclude these subsidiaries from those models that include objective variables. Although an overall 41-percent response rate is generally considered reasonable, caution is warranted when one considers the broader implications of our results.

Control Variables

We control for country-level factors that may influence the firms’ location choices. *Gross Domestic Product (GDP)* and *GDP Growth*, drawn from the Penn World Table, are used as proxies for market size and potential (Caves, 2007). *GDP Growth* is measured as the average annual growth in real GDP in the preceding three-year period. We include *GDP per Capita* as a measure of a country’s degree of prosperity, as well as a proxy for overall labor costs¹ (Mayer, Mejean, & Nefussi, 2010), and *Population* as a proxy for general labor supply. Drawing on data from the World Trade Organization (WTO), we measure *Trade Ratio* as the ratio of a country’s total exports and imports to its GDP, which reflects a country’s level of integration into the global economy. We also include *FDI Stock*, using data from the United Nations Conference on Trade and Development (UNCTAD), to capture the country’s general attractiveness to foreign investors.

We include three variables to control for a host country’s institutional environment. We control for the influence of *Cultural Distance* on FDI using Hofstede’s cultural dimensions (Hofstede, 2001). We also draw on the POLCON database to create the variable *Policy Stability* to measure the stability of government policies (Henisz, 2002). *Rule of Law* is drawn from the governance indicators developed by Kaufmann et al. (2008). For the missing data years, we interpolate using the closest year for which data are available. We also include *Geographic*

Distance, measured as the distance in thousands of kilometers between Tokyo and a host country's most populated city.

We include *Prior Production Investment* and *Prior Trading Investment*, which are respectively measured as the logged count of a firm's prior production and trading entries into a host country, to account for the firms' propensity to repeatedly enter the same country (Chang, 1995)². We also include *Prior Industry Investment*, measured as the logged count of production entries into a country by other Japanese firms in the same industry, to control for the influence of other firms' investments on a focal firm's entry decision (Jiang, Holburn, & Beamish, 2014).

Estimation Approach

Our analysis employs mixed logit models, which provide a flexible way to examine patterns in discrete choices such as investment locations. A generalized version of the conditional logit model, the mixed logit model, allows for random preference variation, unrestricted substitution patterns, and correlation in unobserved factors over time (Train, 2009). The mixed logit model specifies the unobserved portion of utility as a combination of an independent and identically distributed (iid) extreme value error term and a randomly distributed component that reflects variation in choosers' preferences. Thus, a researcher can specify some coefficients to be fixed in the population, as in a conditional logit model, and others to vary across choice sets in order to capture heterogeneity in the decision maker's preferences.

In our study, the coefficient for *Income Inequality* is set to vary across entry decisions because we expect its influence to vary depending on investment objectives. Because of this unique specification, the output of mixed logit models consists of parameters that characterize the distribution of the mean of the randomized coefficient *and* the distribution of the standard

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deviation of the mean preference. More specifically, a statistically significant mean estimate suggests that cross-country income inequality influences entry decisions, and a statistically significant estimated standard deviation indicates that this influence varies across investments.

We further include the products of *Income Inequality* and binary investment objective variables to analyze the preference heterogeneity in the effect of *Income Inequality* that is attributable to investment objective (Revelt & Train, 1998). For instance, a statistically significant coefficient estimate for the interaction term *Income Inequality * Efficiency-Seeking (Labor)* would indicate heterogeneity in firms' response to income inequality around that specific investment objective. Since the investment objective variables do not vary within choice sets, they will appear only as a part of the interaction terms but not as standalone regressors. In addition, the mixed logit model is especially useful in controlling the correlation resulting from the making of repeated choices by the same firm, which occurs in our data (Revelt & Train, 1998). We follow prior studies by approximating the choice probability through simulation and maximizing the simulated log-likelihood function. Simulations were performed using 100 Halton draws (Revelt & Train, 1998). Increasing the number of draws did not lead to material changes in the parameter estimates.

Our final sample includes 14,031 production entries out of a total 1,078,931 firm-year-country observations when investment objective variables are excluded from a specification. The numbers of observations and entries decrease to 448,310 and 5,946, respectively, when investment objective variables are included in a specification. Table 1 reports the frequencies of occurrence of various investment objectives. These data suggests that firms may pursue multiple objectives when establishing a foreign production subsidiary. For example, a subsidiary can simultaneously seek to access local labor and pursue local market opportunities. There is little

theoretical guidance in the literature to help determine when one objective may supersede the other. We thus allow a subsidiary to be associated with multiple investment objectives, and model the interaction effects between *Income Inequality* and various objective variables separately. This approach avoids arbitrarily creating conceptually distinct subsidiary categories without sufficient theoretical justification. We center *Income Inequality* before entering it into interaction terms to mitigate potential multicollinearity.

Insert Table 1 about here

Results

Table 2 reports the summary statistics and the correlations of the variables. Table 3 presents the results of the mixed logit models. Model 1 is the benchmark specification that includes the linear effect of income inequality but contains no interaction terms, which are introduced to Models 2-9. The coefficient for *Income Inequality* in Model 1 is positive and statistically significant ($p < 0.01$). What is equally informative is the statistically significant estimated standard deviation of the coefficient ($p < 0.01$), which indicates that the positive effect of *Income Inequality* varies across investments. This result confirms that it is necessary to explore boundary conditions – including investment objective – that may lead to variation in the effect of income inequality.

Insert Tables 2 & 3 about here

Hypothesis 1 proposes that income inequality has an inverted U-shaped relationship with production entry. To test this hypothesis, we include a quadratic term – *Income Inequality*

Square – in Model 2. The coefficient estimate for the quadratic term is negative and statistically significant ($p<0.01$), suggesting that the positive effect of *Income Inequality* decreases at higher levels of income inequality. Thus, Hypothesis 1 is supported. Further analysis indicates that inflection occurs around Gini=47.6, with 12 countries above the inflection point and 60 below. Host countries that had this level of income inequality in the 2000s include Mexico, Zambia, and Panama. When a host country's Gini index exceeds this level, the positive effect of inequality on production entry begins to decrease. Countries falling into this category in the 2000s include Angola, Honduras, Peru, and Colombia.

To illustrate the implications of this finding, we consider the case of China, one of the primary destinations for Japanese outward FDI during the study period. The Gini index of this country has steadily increased from 30.0 to 33.5 in late 1980s to about 53.5 in early 2010s. Hence, China's inequality was rising along with FDI until it reached and exceeded the inflection point (in 2002) based on our sample of Japanese production entries. Our results imply that China could have attracted more investment in recent years if inequality remained at the level of 2002. In recent years the Chinese government has listed reducing inequality as a policy priority (Zhuang, 2016). We speculate that if the Chinese government and the society in general fail to address this issue, foreign investment may begin to dwindle and lead to a more closed market economy.

Over the same period, inequality in the US has risen from about 33.0 in late 1980s to around 37.5 in early 2010s. While this is moderate among all countries worldwide, inequality in the US is high compared to other developed democracies. Our results predict that the US will continue to be a popular destination for FDI as inequality rises, while at the same time developing an increasingly fractious society, a process that is already fairly evident in the current

day (Chin, 2017). These observations, of course, are only valid while holding all other factors constant. Labor productivity, talent pool size and depth, and market attractiveness all provide strong countervailing forces to that of income inequality on location attractiveness.

Hypothesis 2 proposes that the inverted U-shaped relationship between income inequality and production entry will be stronger when the new subsidiary has an efficiency-seeking mandate. The interaction terms between efficiency-seeking mandate variables and *Income Inequality* and *Income Inequality Square* are introduced to Models 3-6 to test the hypothesis. The coefficient estimates for the interaction terms between investment purposes and *Income Inequality* are all positive and statistically significant. The coefficient estimates for the interaction terms between investment purposes and *Income Inequality Square* are all negative and statistically significant, except for the coefficient estimate for *Income Inequality Square * Efficiency-Seeking (Production Network)*, which is signed as expected but statistically non-significant. Overall, the results suggest that an efficiency-seeking objective accentuates the inverted U-shaped effect of income inequality on production entry in that it enhances the positive effect in the lower range of income inequality, thus leading to a steeper upward curvature, and precipitates the decline in entry probability in the higher range of income inequality. Thus, Hypothesis 2 is supported.

We further illustrate the moderation effect in Figure 1 using *Efficiency-Seeking (Labor)* as an example. The diagrams in the left column contrast the simulated probabilities of production entry when the labor-seeking objective is missing and present. Since simulation draws repeatedly from the distributions of estimated parameters, each inequality value corresponds to more than one simulated entry probability, thus the width of the curve. When *Efficiency-Seeking (Labor)* is equal to one, the upper curvature becomes steeper than when the variable is set to zero, and the

inflection point shifts rightward. The differences in the shape of the two curves are consistent with coefficient estimates reported in Table 2.

Hypothesis 3 proposes that the relationship between income inequality and production entry will be weaker in the case of a competence-enhancing mandate. To test this hypothesis, we include the term *Income Inequality * Competence-Enhancing* and *Income Inequality Square * Market-Seeking* in Model 7. The coefficient estimates for both interaction terms are signed as expected and statistically significant. The results indicate that a competence-enhancing purpose reduces the positive effect in the lower range of income inequality, resulting in a flatter upward curvature, and attenuates the decline in entry probability in the higher range of income inequality, thus supporting the hypothesis. The diagrams in the central column in Figure 1 further demonstrate the moderation effect, where the inflection point shifts leftward significantly, the peak values are smaller, and the inverted U-shaped curve is significantly flatter when *Competence-Enhancing* is set to one.

Finally, Hypothesis 4 suggests that a market-seeking mandate will weaken the relationship between income inequality and production entry. The coefficient estimates for the interaction terms *Income Inequality * Market-Seeking* and *Income Inequality Square * Market-Seeking* in Model 8 are both statistically significant and signed as expected. Additional graphic analysis (the diagrams in the right column in Figure 1) further verifies this result, showing that the peak values at the inflection point are smaller and that the inverted U-shaped curve is significantly flatter. Therefore, Hypothesis 4 is strongly supported.

Estimation results for *GDP*, *GDP Growth*, and *Population* indicate that Japanese firms are more likely to enter countries with a larger market size and a higher economic growth rate. However, *GDP per Capita* does not significantly affect entry decisions. *Trade Ratio* is

negatively related to production investment, possibly because trade barriers have a substitution effect on FDI (Markusen, 1995). We found *FDI Stock* to be negatively related to production entry. This result reflects the fact that countries with high levels of FDI stock are mostly developed countries, which tend to import manufactured goods from less developed countries. A large *Geographic Distance* between Japan and a potential host country deters production investment. In contrast, *Rule of Law* has a positive effect on production entry. However, the impact of *Policy Stability* appears to be negative, and *Cultural Distance* is positively related to entry decisions. The somewhat unexpected results on *Policy Stability* and *Cultural Distance* may reflect the fact that most entries in our sample occurred in the 1990s and early 2000s, when many of the sampled firms had overcome the initial institutional barriers through their previous investments in the 1970s and early 1980s. As we expected, prior entries into a host country by a focal firm and its industry peers strongly influence the firm's propensity to enter the same country.

Robustness of Findings

We conduct additional analyses to examine the robustness of our results to alternative sampling and estimation approaches. Table 4 reports the results of these analyses. First, we estimate a conditional logit model, which is a commonly used method in the location choice literature, for our sample. Since the conditional logit model does not accommodate chooser-specific attributes (i.e. investment objectives), we can only estimate the effects of *Income Inequality* and its quadratic term. The estimation results (Models 9 and 10) are highly consistent with those from the mixed logit models (Models 1 and 2), thus confirming the validity of our estimation approach³.

Insert Table 4 about here

In addition, China received a large number of production investments during the study period (35 percent of all entries)⁴. To ensure that our results are not disproportionately driven by the idiosyncrasies of one host country, we re-estimate our model on a modified sample that excludes China from the country choice set (Models 11-18). The coefficient estimates in terms of theoretical interest in these models are consistent with those reported in Models 1-8, confirming the reliability of our findings. We also exclude small subsidiaries with fewer than 20 employees to ensure that our results reflect the locational patterns of investment with economic significance (Beamish & Inkpen, 1998). The results are consistent with the reported findings⁵.

Discussion

Our study contributes to inequality research by providing evidence on how MNEs respond to national differences in income inequality when making location decisions. While increasing income inequality contributes to societal ills, including declining trust in business and institutions and socio-political instability, in the short term it can also provide MNEs with easier and cheaper access to labor while reducing CSOs’ engagement, which typically increases costs. Therefore, at low levels of inequality, location attractiveness increases with income inequality. However, as inequality reaches higher levels, the cost-economizing opportunities previously observed are increasingly offset by the higher cost associated with an unstable socio-political environment, and by reduced trust and cooperation among institutional actors. Furthermore,

actions taken by the state to reduce inequality, through taxation and redistribution, also increase the cost incurred by the production subsidiary, thus reducing location attractiveness.

We undertook this study to complement macroeconomic studies on income inequality by examining its effect in the context of organizations (Morris & Western, 1999) and its influence on management decision-making (Marens, 2018). To achieve this, we focused on a particularly consequential decision – investment location choice – made by transnational organizations. We then embedded the motives of these companies into the location decision by examining the impact of varying degrees of inequality on the cost efficiency with which those objectives may be achieved. Cobb (2016) and Lewellyn (2018) argue that broader institutional forces, most notably the relative influence of capital-based financial systems, induce corporations to engage in compensation practices that contribute to income inequality. Our approach builds upon this institutional lens, and acknowledges the co-evolutionary nature of the organization and its environment in which each shapes the other (Alamgir & Cairns, 2015; Beal & Astakhova, 2017; Davis, 2017). What this means, in the context of the current study, is that among the many criteria for MNE location decisions, income inequality appears to have some effects that have been previously overlooked. While the impact of many of the stakeholders (unions, governments, and CSOs) have been identified by international business scholars as affecting location attractiveness (Flores & Aguilera, 2007; Jain, Kothari, & Kumar, 2016), our research sheds light on the offsetting mechanisms through which the cost associated with these institutional actors alters a location's attractiveness.

Davis (2013) predicts the demise of the traditional joint-stock corporation due to its declining social functions (job provision, retirement security provisioning, acting as a vehicle for savings). However, the results of our study suggest that the MNE may extend the organizational

life cycle of corporations by disaggregating supply chain segments of varying fit to different institutional environments. As MNEs enter these new geographically distributed institutional spaces, they will inevitably shift the course of their evolution. Given the association between income inequality and location attractiveness, our findings suggest that higher levels of inequality are more attractive to foreign production investments that prioritize cost efficiency. These investments may actually reduce inequality by increasing host country employment and potentially raising wage levels, especially at the lower end of the income distribution (Park, 2017).

Our research provides empirical evidence to support the effect of income inequality on firm behavior, as postulated by Beal & Astakhova (2017), with a focus on discrete FDI location decisions. While the current study does not examine the eventual impact of FDI on inequality, it does offer insights that are useful for extending the existing discussion on this subject. The majority of the research investigating the relationship between FDI and income inequality has ignored the specific goals of individual MNEs (Lin, Kim, & Wu, 2013; Wu & Hsu, 2012). Our study highlights their motivations and economic interests in our theoretical formulation. Future research can use this finding to support research on how aggregate FDI may influence the trajectory of within- or between-country income inequalities. While research has already been conducted in this area, its findings are mixed (Halmos, 2011; Herzer, Hühne, & Nunnenkamp, 2014) and context-dependent (Deng & Lin, 2013). Future research could examine how the prevalence of different motives for FDI can provide guidance to policy makers interested in both creating and allocating value. While it is beyond the scope of this study, we suggest that further research needs to be conducted with a more refined lens, inclusive of these motives, on how FDI influences inequality.

Finally, the empirical scope of this study is quite broad, in the sense that numerous countries (87), each with their own macroeconomic, political, and institutional characteristics, have been considered as alternate potential locations for investment. We thus overcome the issue of reduced country representation, which has been highlighted as a potential threat to the generalizability of research on inequality (Beramendi & Rueda, 2014). Our study was undertaken to specifically motivate such research, as the current organization/inequality research nexus is more focused on how inequality within an organization impacts its processes, and how income inequality within a society impacts the legitimacy of various organizational forms (Bapuji, 2015). In this sense, our findings underscore the usefulness of the governance triangles framework, which identifies private firms, CSOs, and policy makers as fundamental forces that shape regulation and economic behavior globally (Abbott, 2012). Although MNEs can enact significant global influence, they are often limited in their efforts to tackle global issues due to their primary concerns for remaining competitive, especially the need to continually enhance efficiency. Meanwhile, the scope of governments' influence is defined by sovereignty boundaries, and CSOs typically have fewer resources to enact their interests. As with other major global problems (Abbott, 2012), inequality and its consequences can only be dealt with effectively through concerted interaction between all three sets of actors.

Limitations and Future Avenues for Research

Our findings must be considered within the limitations of the study, which in turn should be addressed in future research. First, lack of data availability prevents us from examining the issue of subnational variations in income inequality, which is salient in such large and diverse economies as China and the United States. A finer-grained analysis of the relationship between

income inequality and MNE investment at a subnational level has the potential to reveal more nuanced effects of inequality, because the investment environment is otherwise more homogeneous.

The generalizability of our findings could be limited by the fact that our sample includes Japanese MNEs only, although these MNEs have been found to be a suitable basis for a great number and variety of MNE studies (Delios & Beamish, 1999; Delios & Henisz, 2003; Head et al., 1995; Hennart & Park, 1994). Firms' responses to host country income inequality could be conditioned by the home country's dominant institutional view of inequality (Holburn & Zelner, 2010). There is evidence that individuals acculturated to a high level of power distance tend to be more tolerant of inequality (Craig, Douglas, & Grein, 1992; Daniels & Greguras, 2014). For example, Andrews and Htun (2018) found that cultural orientation moderates the negative effects of inequality (e.g. lack of trust) within the organization. Given that Japanese managers tend to accept moderate levels of power distance (Hofstede, 2001), the costs associated with inequality in locations with similar, or lower, levels of power distance may seem more acceptable, hence introducing bias towards such locations. Furthermore, Japanese firms are characterized by high levels of institutional ownership (i.e. banks and *keiretsu* members). While large block ownership can improve monitoring (Li, 1994), extensive use of interlocking directorates can also lead to excessive risk-taking (Buckley & Strange, 2011). It would therefore be fruitful to use a sample of firms from different home countries to further test and refine the role of culture in our theoretical model. A multi-home-country design would be particularly useful to reveal how the difference in inequality between home and host countries influences MNE geographic expansion.

Future research could consider the extent to which our results depend on the type of inequality (i.e. income, wealth, social, etc.). Social inequality can, for example, be attributed to

gender, racial, familial, or tribal classifications, and these divisions are often reflected in income differences (Kilgour, 2012; Smith, 2002). Inequality may incite less political unrest when based on some demographic differences and not others, and thus not significantly diminish location attractiveness. On the other hand, social divisions based on family, race, or tribal affiliations are more likely to create heightened political pressures, which may escalate in violence. Hence, the effect of inequality on location attractiveness is probably more nuanced than the higher-level evidence provided. Future research should also investigate how other aspects of foreign investment decision-making are likely to be influenced by national income inequality. In particular, researchers should examine how different modes of entry (i.e. joint ventures versus wholly owned subsidiaries, acquisitions versus greenfield, etc.) may be selected based on the level of inequality within the nation or region, and how the choices of investment location and entry mode impact subsidiary and overall firm performance.

Conclusion

We aimed to start a discussion on the role of MNEs in responding to and potentially shaping income inequality. We established the existence of a relationship between income inequality and location choice, which is dependent upon the investment objectives of the MNE. Policy makers can use our results to make more informed decisions about FDI policy by taking into account the objectives of the MNE (Herrera-Echeverri, Haar, & Estevez-Breton, 2014). Moreover, the state's desire to improve economic conditions through FDI is unlikely to have the desired impact without first understanding the full implications of the firms' preferences. Similarly, policies designed to ameliorate the undesirable social effects of inequality may be incomplete,

ineffective, or much more difficult to achieve if the economic implications and organizational perspectives on income inequality are ignored.

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Notes

1. We thank an anonymous reviewer for suggesting we include *wage* in our models. Drawing on the labor costs data published by the International Labor Organization (ILO), we ran an additional model with this variable specified. The sample size declined by approximately 65 percent due to the temporal and geographic constraints of the ILO data; the number of host countries also decreased, from 87 to 69. The results were largely consistent with those reported in Table 3 and, since GDP per capita is a widely accepted proxy for compensation, we chose to exclude *wage* from our final model.
2. A diagnostic analysis indicates that the count variables of prior entries are skewed, hence the logarithm transformation.
3. Since the conditional logit model is a fixed-effects model, the variance of coefficient estimates is not available.
4. Our sample includes entries into 87 host countries. Other leading recipients of Japanese foreign production investment are, in descending order: the United States, Thailand, Indonesia, Malaysia, Taiwan, South Korea, Vietnam, Hong Kong, the Philippines, Singapore, the United Kingdom, India, France, and Germany. Each of these countries accounted for more than 1 percent of the total entries during the study period.
5. Exhibits were omitted due to space constraints.

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Table 1. Entries by Investment Objective.

Self-reported investment objectives	Count
Efficiency-Seeking	
Efficiency-Seeking (Labor)	2,047
Efficiency-Seeking (Production Network)	3,956
Efficiency-Seeking (Export Others)	759
Efficiency-Seeking (Export Japan)	1,187
Competence-Enhancing	396
Market-Seeking	3,810

Table 2. Descriptive Statistics and Bivariate Correlations.

Variables	Mean	S. D.	Min	Max	1	2	3	4	5	6	7	8	9	10
1 Entry	0.01	0.11	0	1										
2 Income Inequality	37.0	9.49	18.0	62.6	0.024									
3 Efficiency-Seeking (Labor)	0.34	0.47	0	1	0.000	-0.002								
4 Efficiency-Seeking (Production Network)	0.68	0.47	0	1	-0.003	0.014	0.080							
5 Efficiency-Seeking (Export Others)	0.13	0.33	0	1	0.001	-0.004	0.160	0.031						
6 Efficiency-Seeking (Export Japan)	0.20	0.40	0	1	0.000	-0.003	0.258	0.045	0.180					
7 Market-Seeking	0.64	0.48	0	1	0.000	-0.001	-0.025	-0.082	0.039	-0.081				
8 Competence-Enhancing	0.07	0.25	0	1	0.000	0.000	-0.075	-0.012	-0.014	-0.016	-0.031			
9 GDP	0.49	1.29	0.00	13.2	0.236	-0.010	-0.008	0.011	-0.006	-0.011	-0.005	0.000		
10 GDP Growth	0.04	0.06	-0.31	0.74	0.051	0.062	-0.011	0.012	-0.007	-0.025	-0.008	-0.003	0.004	
11 GDP per capita	0.01	0.01	0.00	0.07	-0.014	-0.564	-0.019	0.030	-0.015	-0.026	-0.011	0.001	0.253	-0.019
12 Population	0.06	0.17	0.00	1.32	0.303	0.126	-0.001	0.000	-0.001	-0.002	-0.001	0.000	0.521	0.080
13 Trade Ratio	0.57	1.92	0.03	23.0	-0.017	-0.160	-0.005	-0.001	-0.001	-0.003	-0.001	0.000	-0.059	0.053
14 FDI Stock	0.07	0.23	0.00	3.55	0.067	-0.066	-0.024	0.031	-0.018	-0.033	-0.014	0.002	0.751	-0.028
15 Geographic Distance	9.86	3.74	1.16	18.6	-0.156	0.418	0.002	0.000	0.001	0.001	0.000	0.000	-0.116	-0.078
16 Rule of Law	0.37	0.98	-1.70	2.00	-0.010	-0.646	0.001	-0.013	0.003	0.000	0.000	0.000	0.133	0.014
17 Policy Stability	0.35	0.19	0	0.72	-0.082	-0.253	-0.006	0.036	-0.008	0.002	0.001	0.000	-0.012	-0.003
18 Cultural Distance	3.17	1.68	0.71	8.88	0.018	-0.181	-0.002	0.006	-0.002	-0.001	0.000	0.000	-0.069	-0.021
19 Prior Production Investment	0.05	0.22	0	4.03	0.161	0.018	-0.029	0.000	0.001	-0.030	-0.007	-0.004	0.325	0.043
20 Prior Trading Investment	0.03	0.18	0	3.95	0.058	-0.022	-0.020	-0.012	0.005	-0.014	-0.022	0.009	0.224	0.012
21 Prior Industry Investment	0.97	1.37	0	6.81	0.225	-0.033	-0.008	0.017	-0.003	-0.022	0.005	0.008	0.508	0.097
Variables					11	12	13	14	15	16	17	18	19	20
12 Population					-0.158									
13 Trade Ratio					0.252	-0.076								
14 FDI Stock					0.435	0.136	0.009							
15 Geographic Distance					-0.202	-0.279	-0.046	-0.041						
16 Rule of Law					0.819	-0.142	0.198	0.258	-0.221					
17 Policy Stability					0.338	-0.161	0.071	0.052	0.148	0.378				
18 Cultural Distance					0.167	-0.049	-0.016	-0.008	-0.229	0.238	-0.029			
19 Prior Production Investment					0.068	0.217	-0.015	0.210	-0.170	0.049	-0.043	0.012		
20 Prior Trading Investment					0.128	0.060	0.000	0.178	-0.073	0.107	-0.006	0.002	0.436	
21 Prior Industry Investment					0.260	0.364	-0.019	0.395	-0.421	0.210	-0.023	0.002	0.366	0.239

N=448,310; Correlation with absolute values greater than 0.003 are significant at the $p < 0.05$.

Table 3. Mixed Logit Models of Production Entries.

Variables		Model 1	Model 2	Model 3	Model 4	Model 5	Model 6	Model 7	Model 8
Income Inequality	(mean coefficient)	0.07 **	0.25 **	0.01	0.13 **	0.24 **	0.19 **	0.32 **	0.35 **
		(0.02)	(0.02)	(0.04)	(0.05)	(0.04)	(0.04)	(0.04)	(0.05)
	(standard deviation of coefficient)	0.17 **	0.27 **	0.28 **	0.3 **	0.29 **	0.29 **	0.29 **	0.29 **
Income Inequality Square	(mean coefficient)		-0.41 **	-0.42 **	-0.49 **	-0.47 **	-0.44 **	-0.51 **	-0.61 **
			(0.02)	(0.03)	(0.04)	(0.03)	(0.03)	(0.03)	(0.05)
	(standard deviation of coefficient)		0.21 **	0.25 **	0.26 **	0.26 **	0.26 **	0.26 **	0.25 **
Income Inequality *Efficiency-Seeking (Labor)			(0.02)	0.75 **	(0.05)	(0.05)	(0.05)	(0.05)	(0.05)
				(0.06)					
				-0.27 **					
Income Inequality Square *Efficiency-Seeking (Labor)				(0.06)					
					0.22 **				
					(0.05)				
Income Inequality Square *Efficiency-Seeking (Production Network)					-0.01				
					(0.05)				
						0.14 *			
Income Inequality Square *Efficiency-Seeking (Export Others)						(0.07)			
						-0.17 *			
						(0.08)			
Income Inequality Square *Efficiency-Seeking (Export Japan)							0.36 **		
							(0.06)		
							-0.31 **		
Income Inequality Square *Efficiency-Seeking (Export Japan)							(0.07)		
								-0.74 **	
								(0.08)	
Income Inequality Square *Competence-Enhancing								0.17 *	
								(0.08)	
									-0.12 *
Income Inequality Square *Market-Seeking									(0.05)
									0.19 **
									(0.05)
GDP		0.01	0.06 **	0.09 **	0.08 **	0.08 **	0.08 **	0.08 **	0.08 **
		(0.01)	(0.01)	(0.02)	(0.02)	(0.02)	(0.02)	(0.02)	(0.02)
GDP Growth		1.9 **	2.45 **	3.29 **	3.06 **	3.15 **	3.14 **	3.18 **	3.15 **
		(0.27)	(0.27)	(0.42)	(0.42)	(0.42)	(0.42)	(0.42)	(0.42)
GDP per capita		-1.15	-2.5	-6.96	-3.84	-4.53	-4.8	-5.17	-4.45
		(2.72)	(2.79)	(4.65)	(4.68)	(4.67)	(4.66)	(4.66)	(4.67)
Population		0.88 **	0.85 **	0.72 **	0.75 **	0.75 **	0.75 **	0.74 **	0.75 **
		(0.04)	(0.04)	(0.07)	(0.07)	(0.07)	(0.07)	(0.07)	(0.07)
FDI Stock		0.09 **	-0.24 **	-0.41 **	-0.39 **	-0.39 **	-0.39 **	-0.4 **	-0.39 **
		(0.03)	(0.03)	(0.06)	(0.06)	(0.06)	(0.06)	(0.06)	(0.06)
Trade Ratio		-0.32 **	-0.3 **	-0.33 **	-0.36 **	-0.35 **	-0.35 **	-0.35 **	-0.35 **
		(0.04)	(0.04)	(0.06)	(0.06)	(0.06)	(0.06)	(0.06)	(0.06)
Geographic Distance		-0.07 **	-0.08 **	-0.11 **	-0.11 **	-0.11 **	-0.11 **	-0.11 **	-0.11 **
		(0.01)	(0.01)	(0.01)	(0.01)	(0.01)	(0.01)	(0.01)	(0.01)
Cultural Distance		0.05 **	0.02 †	0.08 **	0.09 **	0.09 **	0.09 **	0.09 **	0.09 **
		(0.01)	(0.01)	(0.02)	(0.02)	(0.02)	(0.02)	(0.02)	(0.02)
Policy Stability		-0.29 **	-0.26 **	-0.22 †	-0.19	-0.19	-0.19	-0.20 †	-0.19
		(0.07)	(0.08)	(0.12)	(0.12)	(0.12)	(0.12)	(0.12)	(0.12)
Rule of Law		0.09 **	0.19 **	0.2 **	0.19 **	0.19 **	0.19 **	0.19 **	0.19 **
		(0.03)	(0.03)	(0.05)	(0.05)	(0.05)	(0.05)	(0.05)	(0.05)
Prior Production Investment		0.08 **	0.1 **	0.12 **	0.12 **	0.12 **	0.12 **	0.11 **	0.11 **
		(0.02)	(0.02)	(0.04)	(0.04)	(0.04)	(0.04)	(0.04)	(0.04)
Prior Trading Investment		0.15 **	0.13 **	0.00	0.00	0.00	0.00	0.00	0.00
		(0.03)	(0.03)	(0.06)	(0.06)	(0.06)	(0.06)	(0.06)	(0.06)
Prior Industry Investment		0.91 **	0.84 **	0.88 **	0.88 **	0.89 **	0.89 **	0.88 **	0.88 **
		(0.01)	(0.01)	(0.02)	(0.02)	(0.02)	(0.02)	(0.02)	(0.02)
Number of Observations		1078931	1078931	448310	448310	448310	448310	448310	448310
Log-Likelihood		-36093.1	-35785.2	-14442.2	-14533.2	-14540.7	-14522.8	-14506.5	-14536.4

† p < .10; * p < .05; ** p < .01.

Table 4. Robustness Checks (Alternative Specifications).

Variables		Model 9	Model 10	Model 11	Model 12	Model 13	Model 14	Model 15	Model 16	Model 17	Model 18
		Conditional Logit		Mixed Logit (China excluded)							
Income Inequality	(mean coefficient)	0.06 **	0.21 **	0.08 **	0.18 **	-0.04	0.09 †	0.18 **	0.14 **	0.25 **	0.26 **
		(0.02)	(0.02)	(0.02)	(0.02)	(0.04)	(0.05)	(0.04)	(0.04)	(0.04)	(0.05)
	(standard deviation of coefficient)			0.17 **	0.25 **	0.25 **	0.28 **	0.26 **	0.27 **	0.27 **	0.26 **
			(0.03)	(0.03)	(0.06)	(0.05)	(0.06)	(0.06)	(0.06)	(0.05)	(0.06)
Income Inequality Square	(mean coefficient)		-0.36 **		-0.27 **	-0.18 **	-0.27 **	-0.26 **	-0.22 **	-0.34 **	-0.44 **
			(0.02)		(0.02)	(0.04)	(0.05)	(0.04)	(0.04)	(0.04)	(0.05)
	(standard deviation of coefficient)				0.21 **	0.16 *	0.17 **	0.17 **	0.16 *	0.18 **	0.16 *
					(0.02)	(0.07)	(0.07)	(0.06)	(0.07)	(0.06)	(0.07)
Income Inequality						0.65 **					
*Efficiency-Seeking (Labor)						(0.05)					
Income Inequality Square						-0.37 **					
*Efficiency-Seeking (Labor)						(0.06)					
Income Inequality							0.18 **				
*Efficiency-Seeking (Production Network)							(0.05)				
Income Inequality Square							-0.06				
*Efficiency-Seeking (Production Network)							(0.05)				
Income Inequality								0.07			
*Efficiency-Seeking (Export Others)								(0.07)			
Income Inequality Square								-0.25 **			
*Efficiency-Seeking (Export Others)								(0.08)			
Income Inequality									0.27 **		
*Efficiency-Seeking (Export Japan)									(0.06)		
Income Inequality Square									-0.4 **		
*Efficiency-Seeking (Export Japan)									(0.07)		
Income Inequality										-0.73 **	
*Competence-Enhancing										(0.09)	
Income Inequality Square										0.39 **	
*Competence-Enhancing										(0.08)	
Income Inequality											-0.1 †
*Market-Seeking											(0.05)
Income Inequality Square											0.22 **
*Market-Seeking											(0.05)
GDP		0.00	0.05 **	-0.15 **	-0.06 **	-0.08 **	-0.08 **	-0.08 **	-0.08 **	-0.07 **	-0.08 **
		(0.01)	(0.01)	(0.01)	(0.01)	(0.02)	(0.02)	(0.02)	(0.02)	(0.02)	(0.02)
GDP Growth		1.86 **	2.39 **	1.81 **	1.86 **	2.62 **	2.36 **	2.45 **	2.43 **	2.48 **	2.44 **
		(0.27)	(0.27)	(0.28)	(0.28)	(0.44)	(0.44)	(0.44)	(0.44)	(0.44)	(0.44)
GDP per capita		0.21	0.22	-31.3 **	-24.8 **	-32.1 **	-29 **	-29.9 **	-30 **	-30.3 **	-29.9 **
		(2.7)	(2.75)	(3.07)	(3.15)	(5.25)	(5.29)	(5.28)	(5.27)	(5.27)	(5.28)
Population		0.89 **	0.88 **	1.16 **	1 **	0.95 **	0.96 **	0.98 **	0.97 **	0.95 **	0.97 **
		(0.04)	(0.04)	(0.04)	(0.05)	(0.07)	(0.07)	(0.07)	(0.07)	(0.07)	(0.07)
FDI Stock		-0.33 **	-0.32 **	0.99 **	0.72 **	0.8 **	0.78 **	0.79 **	0.79 **	0.78 **	0.78 **
		(0.04)	(0.04)	(0.1)	(0.11)	(0.19)	(0.19)	(0.19)	(0.19)	(0.19)	(0.19)
Trade Ratio		0.09 **	-0.21 **	-0.26 **	-0.27 **	-0.28 **	-0.31 **	-0.31 **	-0.31 **	-0.3 **	-0.31 **
		(0.03)	(0.03)	(0.04)	(0.04)	(0.06)	(0.06)	(0.06)	(0.06)	(0.06)	(0.06)
Geographic Distance		-0.07 **	-0.08 **	-0.1 **	-0.1 **	-0.13 **	-0.13 **	-0.13 **	-0.13 **	-0.13 **	-0.13 **
		(0.01)	(0.01)	(0)	(0)	(0.01)	(0.01)	(0.01)	(0.01)	(0.01)	(0.01)
Cultural Distance		0.08 **	0.17 **	0.00	-0.01	0.06 **	0.07 **	0.07 **	0.06 **	0.06 **	0.07 **
		(0.03)	(0.03)	(0.01)	(0.01)	(0.02)	(0.02)	(0.02)	(0.02)	(0.02)	(0.02)
Policy Stability		-0.28 **	-0.24 **	-0.7 **	-0.56 **	-0.58 **	-0.54 **	-0.54 **	-0.54 **	-0.55 **	-0.54 **
		(0.07)	(0.08)	(0.08)	(0.08)	(0.13)	(0.13)	(0.13)	(0.13)	(0.13)	(0.13)
Rule of Law		0.05 **	0.03 *	0.31 **	0.31 **	0.33 **	0.32 **	0.32 **	0.33 **	0.33 **	0.33 **
		(0.01)	(0.01)	(0.03)	(0.03)	(0.06)	(0.06)	(0.06)	(0.06)	(0.06)	(0.06)
Prior Production Investment		0.08 **	0.1 **	0.08 **	0.08 **	0.2 **	0.19 **	0.19 **	0.19 **	0.19 **	0.19 **
		(0.02)	(0.02)	(0.02)	(0.02)	(0.04)	(0.04)	(0.04)	(0.04)	(0.04)	(0.04)
Prior Trading Investment		0.14 **	0.11 **	0.1 **	0.08 *	-0.02	-0.02	-0.01	-0.02	-0.02	-0.02
		(0.03)	(0.03)	(0.04)	(0.04)	(0.08)	(0.08)	(0.08)	(0.08)	(0.08)	(0.08)
Prior Industry Investment		0.9 **	0.83 **	0.88 **	0.85 **	0.89 **	0.88 **	0.89 **	0.89 **	0.89 **	0.88 **
		(0.01)	(0.01)	(0.01)	(0.01)	(0.02)	(0.02)	(0.02)	(0.02)	(0.02)	(0.02)
Number of Observations		1079849	1079849	933727	933727	396375	396375	396375	396375	396375	396375
Log-Likelihood		-36152.5	-35870.3	-30485.6	-30404.6	-12408.6	-12485.8	-12486.8	-12469.9	-12456.1	-12482.9

† p < .10; * p < .05; ** p < .01.

Figure 1. Simulated Probability of Production Entry by Investment Objective.