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# The Determinants of Foreign Subsidiary CEO Selection: Effects of Internal and External Network Embeddedness of Foreign Subsidiaries and Market Characteristics of Host Country*

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## Abstract

***Purpose*** – This study empirically analyzes the impact of the internal and external network embeddedness of foreign subsidiaries and local market characteristics of the host country on the CEO selection whether or not to appoint an expatriate as the CEO of a foreign subsidiary.

***Design/methodology*** – To conduct an empirical analysis, we obtained a list of the headquarters of Korean MNCs from the Korea Chamber of Commerce and Industry. Based on the list of HQs, we identified a final list of overseas subsidiaries of Korean MNCs that have entered the world from KOTRA (Trade-Investment Promotion Agency for Korea). Then we conducted an empirical analysis based on the results of 391 questionnaires by employing logistic regression analysis.

***Findings*** – The results of empirical analysis are as follows. First, the higher the subsidiary's internal network embeddedness, the higher the tendency appoint an expatriate as the CEO. Second, the higher the volatility of the local market, the higher the tendency to appoint an expatriate as the CEO. Third, the stronger the competition in the local market, the lower the tendency to appoint a PCN.

***Originality/value*** – This study has significant theoretical implications in that it examines the link between the internal and external embeddedness of overseas subsidiaries and the appointment of parent country nationals (PCNs) as the CEO that prior research has not examined.

**Keywords**: CEO Expatriate Staffing, External Network Embeddedness, Foreign Subsidiary, Internal Network Embeddedness, Korean MNCs
**JEL Classifications**: F20, F23, F29

## 1. Introduction

In the field of international business, the study of multinational corporations (hereafter MNCs) and subsidiaries has been an important research topic that has attracted many scholars for a long time (Bartlett and Ghoshal, 1986; Nohria and Ghoshal, 1994; Werner, 2002). Because MNCs by definition have multiple overseas subsidiaries in various countries, whether these foreign subsidiaries can be managed efficiently and effectively is a matter of competitive advantage that affects the global competitiveness of MNCs, and is ultimately linked to the growth and survival of the MNCs as well (Birkinshaw and Hood, 1998; Frost,

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2001; Frost et. Al., 2002; Roth and Nigh, 1992). In particular, a group of scholars has paid major attention to research related to the staffing decisions of foreign subsidiaries (Delios and Björkman, 2000; Tung, 1982; Harzing, 2001; Gong, 2003). These studies have primarily focused on identifying the factors that influence decisions regarding the use of human resources such as the appointment of parent country nationals (PCNs) dispatched from the headquarters, or host country nationals (HCNs) or third-country nationals (TCNs) (Boyacigiller, 1990; Harzing, 2001; Gong, 2003; Belderbos and Heijltjes, 2005).

Previous research has emphasized the advantages of an assigning expatriate CEOs to executive positions in foreign subsidiaries so that they can operate subsidiaries according to the headquarters' strategic direction by performing control activities appropriate to the MNC's policies and goals. However, they also emphasize disadvantages such as cultural myopia caused by an insufficient understanding of local culture (Egelhoff, 1984; O'Donnell, 2000; Geringer and Hebert, 1989; Wang et al., 1998). On the other hand, when a CEO is appointed from a host country, it is possible to overcome the liabilities of foreignness based on a sufficient understanding of the local market and to capture local business opportunities and perform appropriate management activities, although it may have disadvantages such as smooth communication with the headquarters being impeded, and this may lead to problems of goal mismatch between the subsidiaries and the headquarters (Jensen and Meckling, 1976; Roth and O'Donnell, 1996).

MNCs are embedded in external networks at multiple levels in various ways (Nell, Ambos, and Schlegelmilch, 2011), and the foreign subsidiaries of MNCs are simultaneously embedded in the local business's external business network and the MNE's internal network (Garcia-Pont, Canales, and Noboa, 2009; Yamin and Andersson, 2011). Network embeddedness serves as a means for knowledge gathering (Najafi-Tavani, Giround and Andersson, 2014) and plays a crucial role in the MNC's capacity development and competitive advantage creation (Yamin and Andersson, 2011; Achcaoucaou, Miravitlles and Leon-Darder, 2014). Also, the degree of local embeddedness of subsidiaries influences the strategic decision making of MNCs (Andersson and Forsgren, 2000). Given the significant impact of internal and external network embeddedness on the innovation and performance of MNCs and subsidiaries (Almeida and Phene, 2004; Andersson, Forsgren, and Holm, 2002; Figueiredo, 2011; Garcia-Pont et al, 2009), analyzing the impact of network embeddedness on the CEO staffing decisions of a foreign subsidiary is an important research agenda. It can be expected that network embeddedness and local market characteristics will act as determinants that have a significant influence on the choice of the expatriate CEO of an overseas subsidiary. In addition, it is meaningful to investigate expatriate CEO staffing, not the portion of expatriates in general because staff members in key management positions have a potentially stronger impact on the effectiveness of subsidiaries than just functional or technical positions (Colakoglu, Tarique, and Caligiuri, 2009). Despite this importance, none of the prior studies on the nationality of the CEO of an overseas subsidiary have analyzed the impact of the simultaneous internal and external network embeddedness of the foreign subsidiary. In fact, Prior studies on the CEO nationality of foreign subsidiaries have been mainly focused on country-level characteristics, industry-level characteristics, subsidiary characteristics, MNC headquarters, and the relationship between subsidiaries and headquarters (Harzing, 2001; Gong, 2003; Rickley. and Karim, 2018, Thompson and Keating, 2004; Delios and Bjorkman, 2000; Belderbos and Hejitjes, 2005).

External environmental factors are one of the important determinants influencing an MNC's decisions on HRM practices, control and coordination, subsidiary management, centralization and formalization of multinational headquarters and subsidiaries (Holm, Holmström, and Sharma, 2005; Guar, Delios and Singh, 2007; Thomson and Keating, 2004).

Therefore, we argue that external environmental factors, such as local market characteristics, will affect MNC subsidiary CEO staffing decisions. The nature of the host country itself is one of the factors influencing subsidiary CEO staffing decisions (Ando, Rhee and Park, 2008). The overall features of the environment influence the extent to which external linkages are built (Nell et al., 2011). The level of knowledge about the host country market of foreign subsidiaries required to respond to the characteristics of the local environment can influence subsidiary CEO staffing decisions. With rare exceptions (Tan and Mahoney, 2006; Bebenroth, Li and Sekiguchi, 2008), previous research has not focused on the direct relationship between local market characteristics and foreign subsidiary CEO staffing decisions. Tan and Manhoney (2006) and Bebenroth et al., (2008) examined types of industry that are characterized by great uncertainty; however, they tested their hypotheses based on the ratio of the number of expatriates, not the CEO manager's nationality.

Therefore, this study attempted to investigate the impact of network embeddedness (e.g., internal network embeddedness and external network embeddedness) on the appointment of an expatriate as the CEO of a foreign subsidiary in 391 foreign subsidiaries of Korean MNCs. Also, we aimed to empirically analyze the impact of local market characteristics on the appointment of an expatriate as the CEO of a foreign subsidiary by dividing two aspects of local market volatility and local market competition intensity.

The present study contributes to foreign subsidiary executive staffing literature in two ways. First, this study expands our understanding of foreign subsidiary executive staffing by analyzing the effects of internal and external network embeddedness of a foreign subsidiary on the appointment of an expatriate as the CEO of a foreign subsidiary, which has not been examined in previous studies. Second, this research provides new insights into MNCs' strategic executive staffing decisions in response to market conditions in host markets. By examining the local market characteristics of the host country, such as the volatility of the local market and the local market competition, the empirical results provide further insight into the strategic executive staffing decisions of MNCs.

The structure of this study is as follows. Chapter II reviews related literature and Chapter III presents research hypotheses. Chapter IV presents the research methods. Chapter V presents the results of empirical analysis for hypothesis testing. Finally, in Chapter VI, the conclusion, implications, and limitations of this study are presented.

## 2. Literature Review

The subsidiary CEO staffing strategy is a key strategic tool for MNCs for knowledge management, control and coordination (Guar et al., 2007) and is an important topic that affects the overall performance of MNCs (Ciabuschi, Holm, and Martín Martín, 2014). The main focus of subsidiary CEO staffing decisions is whether to choose a local CEO or an expatriate CEO (Guar et al., 2007). In addition, whether the CEOs of foreign subsidiaries are host country nationals (HCNs) or parent country nationals (PNCs) has a significant impact on the degree of integration of headquarters-subsidiary activities, the degree of localization, and knowledge management (Harzing, 2001; Guar et al., 2007).

Prior literature on the staffing decisions of foreign subsidiaries have focused on the characteristics of the country, industry, subsidiary, and MNC headquarters and the relationship between subsidiary and headquarters (Harzing, 2001; Gong, 2003; Rickley and Karim, 2018; Thompson and Keating, 2004; Delios and Björkman, 2000; Belderbos and Heijltjes, 2005).

The characteristics of the host country are one of the factors influencing subsidiary CEO staffing decisions (Ando et al., 2008). Previous studies analyzed the effects of cultural distance (Gong, 2003) and institutional distance (Rickley and Karim, 2018) on foreign subsidiary staffing decisions. For instance, Rickley and Karim (2018) examined the direct impact of the institutional distance between home and host country on subsidiary CEO staffing decisions from host country nationals (HCNs) to parent country nationals (PCNs). In addition to the country factors, the characteristics of the industry also have an impact on the subsidiary staffing decisions. Industry factors, such as those with high R&D intensity, globally integrated industries, and industries with great uncertainty, are reported to influence foreign subsidiary staffing decisions (Thompson and Keating, 2004; Harzing, 2001; Delios and Bjorkman, 2000; Tan and Mohoney, 2006). Parent firm factors such as international experience (Delios and Björkman, 2000; Rickley and Karim, 2018), host market experience (Ando et al., 2008; Delios and Björkman, 2000), and international strategy of MNCs (Ando et al., 2008), were found to influence foreign subsidiary staffing decisions. The relationship between the MNC headquarters and the subsidiary were found to influence foreign subsidiary staffing decisions as well. For instance, the degree of dependence of the headquarters on the foreign subsidiary (Belderbos and Heijltjes, 2005), inter-organizational ties within the business groups (Belderbos and Heijltjes, 2005), ownership share (Bebenroth et al, 2008; Delios and Björkman, 2000), and the level of global integration a foreign subsidiary in the MNC (Ando et al., 2008) were found to be the factors that have an impact on foreign subsidiary CEO staffing decisions.

Even though the results of these previous studies have increased the collective understanding of the determinants of subsidiary CEO staffing decisions, the possible influence of internal and external network embeddedness and host country market characteristics on foreign subsidiaries' CEO staffing decisions has not been well investigated. In addition to that, the importance of the local market conditions of the host country in subsidiary CEO staffing decisions has been under-represented in most prior research.

Basically, firms are embedded social networks with other actors (Granovetter, 1985). The concept of embeddedness represents the relationships and dependencies of various types of networks and firms (Halinen and Törnroos, 1998) and emphasizes the importance of relationships with other business and institutional actors that can be important drivers of organizational success (Yamin and Andersson, 2011). Existing studies on embeddedness emphasize that firms can acquire strategic assets through social relationships or networks to develop competitive advantages (Uzzi and Gillespie, 2002). Embeddedness is built upon strong social attachments with trust and reciprocity (Figueiredo, 2011). In this context, the concept of network embeddedness has been used to deal with issues related to MNCs (Andersson, Forsgren and Holm, 2002) in that foreign subsidiaries are externally embedded in each local context of the host country and internally embedded in the MNE's network (Garcia-Pont et al., 2009).

External network embeddedness implies that each foreign subsidiary is embedded in a specific business network with customers, suppliers and competitors in the local market of the host country (Bresciani and Ferraris, 2016). Internal network embeddedness means how embedded the foreign subsidiary is with the headquarters or other subsidiaries of the MNC's intra network (Bresciani and Ferraris, 2016). Both internal and external network embeddedness are considered to be a source of knowledge (Figueiredo, 2011) and competitive advantage (Garcia-Pont et al., 2009; Nell et al., 2010). The extant research literature has primarily focused on the impact of internal embeddedness or external embeddedness on knowledge creation in MNCs (Andersson, Björkman, and Forsgren, 2005), product development (Yamin and Andersson, 2011), innovation (Bresciani and Ferraris, 2016; Figueiredo, 2011; Almeida and Phene, 2004; Ciabuschi et al., 2014), and performance

(Andersson et al., 2001; Andersson et al, 2002).

Prior researches on subsidiary CEO staffing decisions have been discussed based on agency theory, resource-based view, knowledge-based view, and organizational learning theory. Agency theory focuses on the relationship between a headquarters and a subsidiary as a principal-agent relationship and analyzes how an agent subsidiary can be aligned with the principal headquarters' objectives. Based on the agency theory, an expatriate CEO as an overseas staffing decision is a means to align the interests of foreign subsidiaries with those of the MNC headquarters (Belderbos and Heijltjes, 2005).

From a resource-based view, local CEOs and expatriate CEOs are considered valuable resources for MNEs with different managerial capabilities (Tan and Mahoney, 2006). Based on the resource-based views, where local adaptation is an important management task for foreign subsidiary staffing decisions, it is very likely that an MNC will appoint a local CEO to a foreign subsidiary (Tan and Mahoney, 2006). In particular, in the case of great market uncertainty or intense competition, the success or failure of the operation in the host country will depend on how the MNC uses human resources.

Meanwhile, from a knowledge-based view and learning perspective, even if a foreign subsidiary has knowledge that can contribute to a competitive advantage for the MNC as a whole, it is likely to remain unrealized due to the nature of the knowledge itself (Najafi-Tavani et al., 2014). How to efficiently transfer and use this type of knowledge in the MNC network is an important task for MNCs to create competitive advantages and even to survive.

In this context, both internal and external embeddedness play an important role in the MNC network in understanding and utilizing this valuable knowledge. In essence, internal network embeddedness and external network embeddedness are both sources of knowledge (Figueiredo, 2011) and sources of learning (Andersson et al., 2002). Here, internal network embeddedness can help to recognize the value of knowledge acquired from each subsidiary of an MNC to a high level (Yamin and Andersson, 2011), and can enable the optimal use of this knowledge for an MNC's internal context. On the other hand, overseas subsidiaries are socially, politically and technologically embedded in external networks with local actors in their own local-specific context in each host country (Andersson et al., 2002). This external network embeddedness provides learning opportunities through exposure to new local knowledge, ideas and opportunities (Andersson et al., 2002), while at the same time gaining in-depth knowledge from trust and mutually beneficial relationships, which in turn enhance subsidiaries' ability to absorb and leverage the new knowledge from the environment (Andersson et al., 2005). As a result, the degree of external network embeddedness helps to create and develop a competitive advantage, while also having a significant impact on performance and innovation (Andersson et al., 2005; Andersson et al., 2002; Yamin and Andersson, 2011). After all, in order for MNCs to make full use of all the knowledge of foreign subsidiaries in their respective countries, there must be sufficient internal and external network embeddedness (Meyer, Mudambi and Narula, 2011). However, the foreign subsidiaries' experience in the host market, which is expected to be valuable to MNCs, is largely embedded in the routines of individuals and organizations (Argote and Ingram, 2000). Therefore, both internal and external network embeddedness should be considered as important factors influencing foreign subsidiary CEO staffing decisions.

Meanwhile, the characteristics of the host country itself are among the factors influencing subsidiary CEO staffing decisions (Ando et al., 2008). The overall nature of the environment influences the extent to which external linkages are built (Nell et al., 2011). The level of knowledge about the host country market of foreign subsidiaries required to respond to the characteristics of the local environment is expected to influence subsidiary CEO staffing decisions. In fact, prior studies have shown that HCNs tend to be deployed more in industries or functional areas where local responsiveness (or localization) is important (Guar et al., 2007; Tan and Mahoney, 2006). In addition, because there is a high risk of under-performing in environments with large uncertainties and unknowns (Tan and Mahoney, 2006; Delios and Björkman, 2000), decisions to assign PCNs or HCNs to executive positions in foreign subsidiaries are very important.

# 3. Hypotheses Development

## 3.1. Internal Network Embeddedness and the Appointment of an Expatriate as the CEO of a Foreign Subsidiary

Previous research has found that efficient communication between the headquarters and foreign subsidiaries is a crucial factor that affects the overall performance of foreign subsidiaries (Ando et al., 2008). In order to be able to interpret messages from overseas accurately and timely, it is necessary to understand the meaning of the headquarters' decisions on overseas subsidiaries (Ando et al., 2008). In this situation, the degree of internal network embeddedness of foreign subsidiaries can have an impact on the extent of such interpreting ability of foreign subsidiaries.

CEOs often have socializing experiences within MNC headquarters' networks during their international assignments, and are often rotated to other subsidiaries within the multinational network (Tan and Mahoney, 2006). Thus, the presence of social ties with other managers in the same MNC can enhance the abundance of previous knowledge transfer channels within the MNC (Guar et al., 2007). In addition, an expatriate CEO's social capital with an MNC's top management team can be used to make decisions that will help them operate (Colakoglu et al, 2009).

Often, expatriate CEOs have a better understanding of corporate policy and the role of individual subsidiaries within a multinational network in MNCs (Tan and Mahoney, 2006; Guar et al., 2007). Therefore, expatriate CEOs may have a greater ability to operate subsidiaries in line with the strategic direction of the headquarters than local CEOs.

Expatriate CEOs are well placed to understand how valuable the knowledge generated by foreign subsidiaries is within the MNC network (Guar et al., 2007). Therefore, as the embeddedness of overseas subsidiaries increases in the MNC internal network, it is possible to accurately grasp the value of the knowledge required for subsidiary operations or the knowledge acquired. As a result, expatriate CEOs are likely to pursue strategies that align with the MNC's overall strategy.

The higher the internal network embeddedness, the more likely it is to be embedded in the MNC's informal communication network (Rickley and Karim, 2018). By carrying out appropriate control activities, it is possible to operate subsidiaries in the strategic direction of the headquarters (Guar et al., 2007).

*H1: Subsidiaries with a high degree (high level) of internal network embeddedness (subsidiary-headquarters embeddedness) are positively related to the appointment of an expatriate as the CEO of a foreign subsidiary.*

## 3.2. External Network Embeddedness and the Appointment of an Expatriate as the CEO of a Foreign Subsidiary

One of the most important reasons for appointing a CEO from a foreign country to an overseas subsidiary is their knowledge of their local market, business practices and cultural preferences (Harzing, 2001). In addition, knowledge of specific customer and supplier relationships in the host country tends to exist for local subsidiary employees (Andersson et al., 2005).

Local embeddedness, such as the subsidiary's individual relationships with customers, suppliers, and competitors in the local market, can be a source of knowledge and can have a positive impact on performance by providing an opportunity to increase the stock of knowledge (Andersson et al., 2005; Bresciani and Ferraris, 2016). However, it takes time for foreign subsidiaries to develop the ability to create close relationships with local business partners (Andersson et al., 2005). Embeddedness is built on strong social attachments (Figueiredo, 2011), and the extraordinary knowledge and skills gained through these connections are important factors in building the skills required for product or service innovation (Figueiredo, 2011; Bresciani and Ferraris, 2016).

In this respect, local CEOs have a local knowledge and local business network that can help MNCs gain valuable local resources or adapt to their local environment (Tan and Mahoney, 2006). The high degree of external network embeddedness may imply that foreign subsidiaries have long known each other and local customers or suppliers, traded for a long time, exchanged information on market conditions and adapted each other's business practices (Andersson et al., 2002). Thus, the higher the external network embeddedness of an overseas subsidiary, the closer it is to local customers and suppliers. This closeness enhances the subsidiary's ability to absorb new knowledge from the local environment (Andersson et al., 2005). In this perspective, local CEOs have greater ability to develop close relationships with local customers or business partners than expatriate CEOs (Tan and and Mohoney, 2006). A better understanding of the needs and capabilities of local firms enables efficient local operations in areas such as marketing and purchasing (Andersson et al., 2002).

Taken together, it is very likely that a local CEO will be appointed to leverage the advantages of the MNC headquarters due to the external network embeddedness of overseas subsidiaries.

*H2: A subsidiary with a high degree (high level) of external network embeddedness (local embeddedness) is negatively related to the appointment of an expatriate as the CEO of a foreign subsidiary.*

## 3.3. Volatility of the Local Market and the Appointment of an Expatriate as the CEO of a Foreign Subsidiary

High volatility in the local market implies market uncertainty. In a highly uncertain and turbulent environment, the likelihood of appointing a local CEO is expected to be higher than that of a Korean CEO from the home country.

It is important for an MNC to have local market knowledge and local relationships to respond to contingencies and mitigate risks in high uncertainty environments (Tan and Mahoney, 2006). Because local CEOs are embedded in the local network and are familiar with local demand preferences (Rickley and Karim, 2018), they are more likely to adapt well to situations in a more volatile local market than expatriate CEOs.

CEOs from host countries have local knowledge and business connections to deal with uncertainty in their markets (Tan and Mahoney, 2006). In addition, local CEOs are well aware of local market-specific issues, such as cultural, economic and political issues for the host country, and can negotiate better with local suppliers or buyers (Ando et al., 2008).

In highly uncertain markets, CEOs are more likely to respond to the environment better if they have closer business relationships than arm's-length market relationships (Figueiredo, 2011; Andersson et al., 2002), therefore a local CEO with the ability to establish close business relationships with customers is expected to be more advantageous.

In addition, local CEOs can respond to market changes faster than their competitors and can defend against adverse effects from unfavorable external environments (Holm et al., 2005). It has been suggested that in a situation where the need for local responsiveness is high, local CEOs are preferred as foreign subsidiary managers because the MNC can use their knowledge and information regarding the local environment (Thomson and Kneating, 2004).

*H3: The degree of the volatility of the local market is negatively related to the appointment of an expatriate as the CEO of a foreign subsidiary.*

### 3.4. Competition in the Local Market and the Appointment of an Expatriate as the CEO of a Foreign Subsidiary

Basically, given that local CEOs share the same culture and language as their local customers (Tan and Mahoney, 2006), it is expected to be more advantageous to appoint a CEO from a host country than from a parent country in terms of competition in the host country market.

As the intensity of market competition in a host country increases, the need for information gathering in order for foreign subsidiaries to respond also increases (Nell et al., 2009). In this situation, the ability of local CEOs to gather the information needed to compete is likely to be higher than that of an expatriate CEO (Tan and Mohoney, 2006).

The higher the market competition, the more likely it is that a complex type of knowledge of the local market will be required, which tends to be better understood and recognized through close relationships (Andersson et al., 2005). Indeed, close contact with the exchange of goods and services enhances the likelihood of new needs or new product development (Andersson et al., 2005).

In addition, the ability to identify and absorb new knowledge in the local market depends on close relationships with business partners (Lane and Lubatkin, 1998). In this respect, since CEOs from local countries share the same culture and language as locals (Tan and Mohoney, 2006), the likelihood of local CEOs to have a closer relationship with businesses or customers in the local network is higher than with expatriate CEOs.

As market competition becomes severe, there is more needs for MNCs to maintain clear and frequent communication with local customers and to be able to better understand their own preferences (Tan and Mohoney, 2006). In this case, a CEO from a local country with a good understanding of the local market can play this role well. It is very difficult and time-consuming for PCNs to be as familiar with the local situation as a CEO from a host country (Harzing, 2001). Previous research has found that local CEOs have a better ability to effectively transform global product ideas to better suit local tastes, thereby increasing the competitiveness of overseas subsidiaries over local competitors (Rickley and Karim, 2018).

Taken together, the more competitive the local market is, the more likely it is to appoint a CEO from a host country rather than a parent country. According to the above discussion, the following hypothesis was derived.

*H4: The degree of local market competition is negatively related to the appointment of an expatriate as the CEO of a foreign subsidiary.*

# 4. Methodology

## 4.1. Data Collection

This study empirically analyzed the impact of the internal and external network embeddedness of foreign subsidiaries and local market characteristics of the host country on the *appointment of an expatriate as the CEO of a foreign subsidiary.*

To conduct an empirical analysis, we obtained a list of the headquarters of Korean MNCs from the Korea Chamber of Commerce and Industry. Based on the list of HQs that we obtained, we were able to obtain the final list of overseas subsidiaries of Korean MNCs that have entered the world from the Korea Trade-Investment Promotion Agency (KOTRA). We conducted a survey of 2302 foreign subsidiaries on the final list. The survey was conducted in parallel with various methods such as telephone, e-mail, fax, and online surveys for 2 months. In order to increase the response rate of the survey, we called the overseas subsidiaries directly and politely asked them to actively participate in the survey. As a result of the survey, we collected 409 copies of the questionnaire. However, we excluded 18 questionnaires from the analysis due to incomplete responses. Finally, we conducted an empirical analysis based on 391 questionnaires.

## 4.2. Measurement

### *4.2.1. Dependent Variable*

The dependent variable of this study is the nationality of the CEOs of Korean MNCs' foreign subsidiaries. Many prior studies have used methods to infer a CEO's nationality from the CEO's name obtained through secondary data (Harzing, 2001; Gong, 2003; Choe Soonkyoo, Lee Jae-Eun and Park Young-Ryeol, 2009). This method is simple but somewhat inaccurate. We obtained the data by directly asking the nationality of the CEO in the survey. We created a variable called CEO nationality for analysis. We gave the variable a value of "1" if the CEO's nationality was Korean and "0" if he (or she) was any other nationality.

### *4.2.2. Independent Variables*

In this study, a foreign subsidiary's network embeddedness (internal and external) and market characteristics of the host country (variability and competition) were considered major independent variables. First, based on the research by Frost et al. (2002), the internal network embeddedness of foreign subsidiaries was measured by the extent of their influence on internal corporate customers, internal corporate suppliers, affiliates, and R&D units within the MNC network.

External network embeddedness was measured based on a study by Andersson et al. (2002; 2005). In other words, to effectively respond to the most important local business relationships, external network embeddedness was measured by how much the foreign subsidiary adapted their (1) product technology, (2) production technology, (3) standard operating procedures, and (4) business practices.

Next, based on studies by Miller and Dröge (1986) and Jaworski and Kohli (1993), the volatility of the local market was measured to the extent that the rate of obsolescence of products and services in the local market, the difficulty in predicting consumer demand and preferences, and the difficulty in predicting competitor behavior were measured.

Finally, based on a study by Miller and Dröge (1986), competition in the local market was measured by the degree of fierce competition between firms in the local market and frequency of entry of new competitors into the local market.

*4.2.3. Control Variables*

In addition to the aforementioned independent variables, this study considered cultural distance, industry dummy (capital-intensive industry and global industry), ownership of HQs, size and age of subsidiaries, and control level of HQs as control variables. First, cultural distance was calculated using a formula proposed by Kogut and Singh (1988), and the detailed formula is as follows.

$$CD_j = \sum_{i=1}^{4} \left\{ \left( I_{ij} - I_{ik} \right)^2 / V_i \right\} / 4 \qquad (1)$$

$CD_j$: the cultural distance between Korea and country (*j*)
$I_{ij}$: country (*j*)'s score on the (*i*)th cultural dimension
$I_{ik}$: the score of Korea on the (*i*)th cultural dimension
$V_i$: the variance of the index of the (*i*)th cultural dimension

Next, two industry dummy variables (capital-intensive industry and global industry) were created to control the influence of industry. Capital-intensive industries include such industries as food and beverage products, textiles and clothing, paper and wood, chemical industries, petrochemicals and pharmaceuticals, basic metal industries, etc. In such an industry, the resources required by overseas subsidiaries are often owned by local governments and local firms, so it is more likely to use CEOs of host country nationals to increase their accessibility to such resources (Gomes-Casseres, 1989; Park Young-Ryeol et al., 2009). Thus, the industry dummy(capital-intensive) variable was measured as a dummy variable with a value of '1' for capital-intensive industries and '0' for other industries.

On the other hand, the global industry includes electricity and electronics, machinery and equipment, transportation equipment and pharmaceutical industries. In general, in the global industry, overseas subsidiaries must have close communication and interaction with their HQs, and sometimes tend to have a high degree of dependence on their HQs. In the case of global industries, it is very likely to use a CEO of home country nationals as the head of a subsidiary (Bartlett and Ghoshal, 1998; Makhija et al., 1997, Park Young-Ryeol et al., 2009). The industry dummy (global) variable was measured as a dummy variable with a value of "1" for global industry and "0" for other industries.

Ownership was measured by the percentage of shares of overseas subsidiaries owned by headquarters (Belderbos and Heijltjes, 2005). The size of the foreign subsidiary was measured by the logarithm of the total number of employees (Björkman, Barner-Rasmussen and Li, 2004; Gupta and Govindarajan, 2000), and the age of the overseas subsidiary was measured by the number of years elapsed from the date of its establishment to the present (Yang, Mudambi and Meyer, 2008). Finally, based on the research by Johnston and Menguc (2007), we measured the level of control by HQs over their subsidiaries to the extent to which the HQ holds some authority in decision making related to the operation of its subsidiary, such as decisions on organizational structure, production/sales/marketing, development of new products and services, human resources management, financial affairs, and establishment of business goals.

## 5. Results

Table 1 presents the regional distribution of research sample in this study. The largest number of overseas subsidiaries were located in Asia (246 firms, 62.9%), followed by North

America (62 firms, 15.9%), Europe (57 firms, 14.6%), South America (13 firms, 3.3), Oceania (8 firms, 2.0%), and Africa (5 firms, 1.3%). Next, <Table 2> shows the distribution of research sample by country. The largest number of overseas subsidiaries were located in China (138 firms, 35.3%), followed by U.S.A (57 firms, 14.6%), Vietnam (26 firms, 6.6%), Germany (12 firms, 3.1), and Etc. (158 firms, 40.4%).

Table 3 shows the results of the validity and reliability analysis of the variables used in this study. As shown in Table 1, exploratory factor analysis shows that each factor has a factor load value of 0.5 or more. Therefore, we judged that there was no significant problem with the validity of the measurement variables. We looked at the Cronbach's alpha value to check the reliability of the variables. As a result, we confirmed that the Cronbach's alpha value was 0.7 or higher for all of them, so we judged that there was no serious problem with the reliability of the variables.

Table 4 presents the results of the descriptive statistics and correlation analysis of the variables used in this study. As you can see in the table, the correlation coefficients between the variables were found to be generally satisfactory, without major problems. However, we conducted an additional analysis to check for potential multicollinearity problems. The preceding studies generally suggest that if the VIF value is less than 10 and the CI value is 30 or less, there is no need to worry too much about the possibility of multicollinearity (Chatterjee, Hadi and Price, 2006; Hair et al., 1998). The analysis showed that both the VIF and CI values were within acceptable values, so the problem of multicollinearity was not considered to be of great concern.

Next, Table 5 presents the results of logistic regression analysis. Model 1 includes only control variables in the regression model, and Model 2 includes control variables and independent variables together in the regression model. First of all, model 1 shows that the industry dummy (capital-intensive) ($p<0.05$), the industry dummy (global) ($p<0.05$), the ownership of HQs ($p<0.05$), and control level of HQs ($p<0.05$) have significantly positive effects on the appointment of an expatriate as the CEO of a foreign subsidiary. Next, Model 2 shows that, as with Model 1, control variables such as the industry dummy (capital-intensive) ($p<0.1$), the industry dummy (global) ($p<0.1$), the ownership of HQs ($p<0.001$), and control level of HQs ($p<0.05$) have significantly positive effects on the appointment of an expatriate as the CEO of a foreign subsidiary, and there are growing tendencies to appoint an expatriate as the CEO.

**Table 1.** Regional Distribution of Overseas Subsidiaries

| | Africa | Asia | Europe | N.America | Oceania | S.America | Total |
|---|---|---|---|---|---|---|---|
| N | 5 | 246. | 57. | 62 | 8 | 13 | 391 |
| % | 1.3 | 62.9 | 14.6 | 15.9 | 2.0 | 3.3 | 100 |

**Table 2.** Country Distribution of Overseas Subsidiaries

| | China | U.S.A | Vietnam | Germany | Etc. | Total |
|---|---|---|---|---|---|---|
| N | 138 | 57 | 26 | 12 | 158 | 391 |
| % | 35.3 | 14.6 | 6.6 | 3.1 | 40.4 | 100 |

**Table 3.** Validity and Reliability Analysis

| | | (1) | (2) | (3) | (4) |
|---|---|---|---|---|---|
| (1) | External Network Embeddedness 1 | .696 | .014 | .165 | .025 |
| | External Network Embeddedness 2 | .794 | .123 | .069 | -.011 |
| | External Network Embeddedness 3 | .802 | .056 | -.020 | .057 |
| | External Network Embeddedness 4 | .791 | .104 | -.009 | .122 |
| (2) | Internal Network Embeddedness 1 | .085 | .753 | -.005 | .012 |
| | Internal Network Embeddedness 2 | .077 | .848 | -.016 | -.039 |
| | Internal Network Embeddedness 3 | .050 | .736 | .065 | .019 |
| | Internal Network Embeddedness 4 | .063 | .666 | -.037 | .110 |
| (3) | Volatility of the Local Market 1 | .124 | .051 | .563 | .348 |
| | Volatility of the Local Market 2 | .079 | -.051 | .886 | .064 |
| | Volatility of the Local Market 3 | .005 | .015 | .872 | .114 |
| (4) | Competition of the Local Market 1 | .126 | -.009 | .249 | .734 |
| | Competition of the Local Market 2 | .007 | .090 | .088 | .844 |
| | Eigen Value | 2.442 | 2.313 | 1.969 | 1.423 |
| | % of Variance | 18.788 | 17.792 | 15.145 | 10.944 |
| | Cumulative % of Variance | 18.788 | 36.580 | 51.725 | 62.669 |
| | Cronbach's Alpha | .781 | .747 | .725 | .737 |

**Table 4.** Results of Descriptive Statistics and Correlation Analysis

| | ① | ② | ③ | ④ | ⑤ | ⑥ | ⑦ | ⑧ | ⑨ | ⑩ | ⑪ | ⑫ |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| ① CEO Nationality | 1 | | | | | | | | | | | |
| ② Cultural Distance | .006 | 1 | | | | | | | | | | |
| ③ Industry Dummy (Capital-intensive) | .058 | -.031 | 1 | | | | | | | | | |
| ④ Industry Dummy (Global) | .084 | .033 | -.29** | 1 | | | | | | | | |
| ⑤ Ownership of HQs | .221** | .123* | -.001 | -.004 | 1 | | | | | | | |
| ⑥ Size of Subsidiary | -.025 | -.221** | -.009 | .229** | -.092 | 1 | | | | | | |
| ⑦ Age of Subsidiary | -.037 | .109* | .003 | -.038 | .013 | .024 | 1 | | | | | |
| ⑧ Control Level of HQs | .139** | .011 | -.081 | .026 | .073 | -.036 | .018 | 1 | | | | |
| ⑨ Volatility of the Local Market | .135** | .097 | -.046 | .106* | .130** | .070 | -.012 | .143** | 1 | | | |
| ⑩ Competition of the Local Market | -.018 | .021 | -.066 | -.006 | .095 | -.063 | .056 | .112* | .377** | 1 | | |
| ⑪ Internal Network Embeddedness | .115* | -.035 | -.024 | -.024 | .012 | .066 | .013 | .071 | .023 | .092 | 1 | |
| ⑫ External Network Embeddedness | .022 | .022 | -.075 | -.072 | .059 | .024 | .034 | .060 | .165** | .157** | .187** | 1 |
| Mean | 0.96 | 2.11 | 0.32 | 0.32 | 87.5 | 4.42 | 2.26 | 3.90 | 4.30 | 4.89 | 4.29 | 4.74 |
| S.D. | 0.19 | 1.06 | 0.47 | 0.46 | 23.6 | 1.84 | 0.76 | 1.31 | 1.20 | 1.25 | 1.06 | 1.09 |

**Note:** * p<0.05, ** p<0.01(2-tailed).

**Table 5.** Results of Logistic Regression Analysis

| | | CEO Nationality (Korean CEO) | |
|---|---|---|---|
| | | **Model 1** | **Model 2** |
| control variables | constant | -1.609<br>(1.813) | -3.568<br>(2.514) |
| | cultural distance | -0.059<br>(0.231) | -0.258<br>(0.256) |
| | industry dummy(capital-intensive) | 1.538*<br>(0.729) | 1.319†<br>(0.736) |
| | industry dummy(global) | 1.840*<br>(0.903) | 1.768†<br>(0.937) |
| | ownership of HQs | 0.034***<br>(0.009) | 0.037***<br>(0.010) |
| | size of subsidiary | -0.020<br>(0.172) | -0.074<br>(0.190) |
| | age of subsidiary | -0.092<br>(0.380) | 0.171<br>(0.439) |
| | control level of HQs | 0.521*<br>(0.231) | 0.511*<br>(0.250) |
| independent variables | internal network embeddedness | | 0.625*<br>(0.267) |
| | external network embeddedness | | 0.032<br>(0.254) |
| | volatility of the local market | | 0.492†<br>(0.266) |
| | competition of the local market | | -0.540*<br>(0.275) |
| Model Chi-square | | 28.703 | 39.200 |
| Correct class-identification ratio | | 96.2 | 96.4 |
| Cox & Snell $R^2$ | | 0.071 | 0.096 |
| Nagelkerke $R^2$ | | 0.245 | 0.330 |
| P-value | | 0.000 | 0.000 |

**Note:** † p<0.1 * p<0.05, ** p<0.01, *** p<0.001 (2-tailed).

We checked the influence of independent variables. First, internal network embeddedness (p<0.05) was found to have a significantly positive effect on CEO nationality. In other words, the higher the internal network embeddedness, the greater the tendency to appoint Korean CEOs to overseas subsidiaries. Hypothesis 1 was therefore supported. Second, external network embeddedness was found to have no significant impact on the appointment of an expatriate as the CEO of a foreign subsidiary. Hypothesis 2 was therefore not supported. Third, volatility of the local market (p<0.1) was found to have a significantly positive effect on the appointment of an expatriate as the CEO of a foreign subsidiary. In other words, the higher the volatility of the local market, the greater the tendency to appoint CEOs from their home country to overseas subsidiaries. Surprisingly, however, Hypothesis 3 was not supported because these results were the opposite of the hypotheses direction expected in this study. There will be further discussion on this in the next chapter. Finally, competition in the local market has a significantly negative impact on the appointment of an expatriate as the

CEO of a foreign subsidiary. In other words, the stronger the competition in the local market ($p<0.05$), the less the tendency to appoint CEOs from their home country to overseas subsidiaries. Hypothesis 4 was therefore supported.

## 6. Conclusion and Discussion

The purpose of this study was to analyze the effects of the internal/external network embeddedness of foreign subsidiaries and local market characteristics on the appointment of an expatriate as the CEO of a foreign subsidiary. The results of the analysis of 391 overseas subsidiaries of Korean MNCs located around the world are as follows. First, the higher the internal network embeddedness of overseas subsidiaries, the higher the tendency to appoint an expatriate as the CEO of a foreign subsidiary. That is, in order to facilitate smooth communication and knowledge transfer between the HQs and their subsidiaries, and to enhance understanding of the strategic direction pursued by the HQs, it suggests that the deeper the subsidiary is embedded in the MNC's network, the more likely it tends to appoint a CEO from its parent country nationals.

Second, Hypothesis 2, which predicted that the higher the external network embeddedness, the lower the tendency to appoint an expatriate as the CEO of a foreign subsidiary, was not supported. Many prior studies have emphasized that MNCs tend to use host-country nationals to acquire host-country-specific knowledge in the local market and enhance local cultural familiarity. However, unlike previous studies, the results of this study showed that foreign subsidiaries' external network embeddedness does not affect an expatriate as the CEO of a foreign subsidiary.

Third, the results of this study suggested that the higher the volatility of the local market, the higher the tendency to appoint an expatriate as the CEO of a foreign subsidiary. These results are the opposite of our prediction that the higher the volatility of the local market, the lower the tendency to appoint an expatriate as the CEO of a foreign subsidiary. Many prior studies argue that MNCs tend to appoint host country nationals with a better understanding of the local market as CEOs of overseas subsidiaries as one way to solve problems under great uncertainties in the local market. However, the results of this study suggest that the MNCs tend to appoint a CEO from their home country who understands the strategic direction set by the HQs and can easily communicate with and transfer knowledge to the HQs.

Fourth, the stronger the competition in the local market, the lower the MNC's tendency to appoint an expatriate as the head of a foreign subsidiary. This trend is consistent with the results emphasized by many prior studies. In other words, the strong competition of the local market requires foreign subsidiaries to have a good understanding of local consumers and local markets. In such a situation, the results of this study suggest that the HQs' tendency to appoint a CEO from their home country as a representative of an overseas subsidiary decreases because local subsidiaries need to quickly acquire knowledge unique to the host country.

In conclusion, this study has the following implications. First, this study has significant theoretical implications in that it examines the link between the internal and external embeddedness of overseas subsidiaries and the appointment of an expatriate as the CEO of a foreign subsidiary, which prior research has not examined. Until now, research on the internal and external embeddedness of overseas subsidiaries has mainly dealt with subsidiary capability development and performance, and the appointment of an expatriate as the CEO of a foreign subsidiary has mainly been seen from the perspective of localization strategy. Based on a knowledge management and network perspective, this study presents a theoretical link between the two topics that have been studied individually, so this study has significant theoretical implications. Second, many prior studies stress that MNCs are less inclined to appoint parent country nationals as their subsidiary CEO when the volatility of the local market is high, but the results of this study rather stress that they are more inclined to appoint parent country nationals as their subsidiary CEO. In other words, this study has theoretical implications because the results of suggest a new perspective that high volatility in the local market increases the tendency to appoint PCNs as the CEOs of subsidiaries, that enables close communication and knowledge transfer between HQs and subsidiaries. Finally, the results of this study can provide meaningful practical implications for MNCs seeking to enter overseas markets in that they provide useful practical guidelines for the appointment of appropriate subsidiary CEOs based on their internal and external embeddedness and the characteristics of the local market.

Despite these implications, this study has the following limitations. First, since this study measured the nationality of a subsidiary CEO in the dummy variable of whether he is Korean or not, it is difficult to identify the nationality of a CEO if he or she is not Korean. In future studies, the nationality of the subsidiary's CEO needs to be identified more specifically and used for analysis. Second, despite the presence of a variety of strategic considerations in the appointment of subsidiary CEOs, such as the role of subsidiaries or global initiatives of MNCs, this study only considers the network embeddedness of subsidiaries and the characteristics of the local market as major factors. For instance, HQ could increase strategic intervention to a subsidiary if the subsidiary does not have enough capabilities to manage and overcome the volatility or competition in a local market. Therefore, the impact of the interaction between the external environment and subsidiary capability can affect the CEO choice rather than that of only external environmental factors. In order to broaden our understanding of CEO choice for overseas subsidiaries, future research needs to include more diverse strategic considerations by MNCs in the research model.

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