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Diplomatic and corporate networks: Bridges to foreign locations

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Abstract

Firms and governments operate in broad networks in which the home government and its diplomatic service are a critical node – or a "referral point" – between firms and potential partners in foreign locations. Thus diplomatic relations between countries matter for the choice of foreign investment location. Using a network perspective, we argue that the extent to which good diplomatic relations induce firms to invest in friendly host countries depends on their political connections to home governments. Those with stronger ties to home governments can better access and leverage intergovernmental diplomatic connections, thus benefiting potentially from enhanced access to information, reduced political risks, and increased legitimacy. Such ability of politically connected firms is more useful where weak institutional impartiality in the host country inhibits neutral treatment of foreign investors. Empirically, using overseas investment location decisions by Chinese firms, we find that the types of home government ties (i.e., whether they are organizational or personal and whether those relationships are with central or local goverments) and the impartiality of host institutions are both important contingencies affecting firms' utilization of diplomatic relations. We discuss the implications of our study to research on network theory, political ties, and internationalization of emerging market firms.

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INTRODUCTION

Networks play an important role in identifying and implementing international investment opportunities and thereby shape the patterns of firms' international growth (Holm, Eriksson, & Johanson, 1996; McDermott & Corredoira, 2010; Tan & Meyer, 2011). Prior studies have highlighted the importance of business networks, in particular for firms that do not yet have local operations and thus an associated local business network in the host country (Coviello, 2006; Ellis, 2011; Forsgren, 2016; Oehme & Bort, 2015; Zhou, Wu, & Luo, 2011). Beyond business ties, an important network that has received scant attention in the international business (IB) literature is the network of diplomatic relations maintained by national governments. In this study, we explore how interactions between business networks and diplomatic relationships can impact firms' foreign location choice.

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We conceptualize diplomatic relationships as ties between political actors in different countries. These diplomatic ties can serve as a 'bridge' between networks in different countries, thus facilitating overseas investment decisions. However, firms do not have equal access to diplomatic networks. Building on advances of network theory, we argue that firms have ties of varying strength and varying length to political actors in home governments who in turn maintain ties to political actors abroad (Borgatti & Halgin, 2011; Burt & Burzynska, 2017; Centola & Macy, 2007; Granovetter, 1973; Podolny, 2001). Those firms with strong ties to home governments are more likely to leverage diplomatic networks for benefits in overseas investments because they can receive earlier and better information, while facing reduced political risks and increased legitimacy.

Firms' political ties to home governments can be created via organizational linkages such as government ownership or via personal linkages such as corporate executives serving in political bodies (Hillman, Zardkoohi, & Bierman, 1999; Li & Zhang, 2007; Peng & Luo, 2000; Sun, Mellahi, Wright, & Xu, 2015), and their tie length varies between firms connected to respectively central and local governments at home (Ma, Ding, & Yuan, 2016; Zheng, Singh, & Mitchell, 2015).

We further argue that the utility of the diplomatic network to firms with home government ties is contingent on the conditions in the target country, notably the impartiality of the institutional framework as exemplified by the rule of law. In host countries with weak impartiality of institutions, government ties are more important to doing business, which increases the potential value of ties to host governments created through the intergovernmental diplomatic network.

We develop three main contributions to the IB literature. First, our study advances our understanding of the geography of multinational enterprises (MNEs) (Beugelsdijk & Mudambi, 2013; Qian, Li, & Rugman, 2013) by exploring the political dimension. Specifically, we present one of the first firm-level studies of the impact of diplomatic relations on location choice (for a review, see Kim & Aguilera, 2016). We argue that the benefits of good diplomatic relations go beyond risk mitigation, as emphasized in Duanmu (2014), and also include opportunity generation and legitimacy enhancement.

Second, our study advances applications of network theory to IB research by focusing on interactions of networks at different levels. While other studies focus on the impact of either macro country-level networks or micro organizational- or individual-level networks (e.g., Makino & Tsang, 2011; Stallkamp, Pinkham, Schotter, & Buchel, 2017; Zaheer, Lamin, & Subramani, 2009), our study emphasizes connections between such networks through referral points in government. Moreover, we recognize heterogeneity in firms' network ties to the home government that affects firms' access to intergovernmental diplomatic networks.

Finally, our study contributes to the recent research on the internationalization of emerging market firms, especially that of state-controlled firms (e.g., Cuervo-Cazurra, Inkpen, Musacchio, & Ramaswamy, 2014; Li, Cui, & Lu, 2014; Liang, Ren, & Sun, 2015; Xia, Ma, Lu, & Yiu, 2014), by providing insights into the conditions under which political ties at home contribute to firms' international investments. Prior research suggests that ties with home governments can become a liability by, for example, raising the national security concerns in the host country (Cui & Jiang, 2012; Li, Xia, & Lin, 2016; Meyer, Ding, Li, & Zhang, 2014). Our study shows that diplomatic relations between countries is an important contingency, with good intergovernmental relations alleviating such legitimacy concerns of host governments.

THEORETICAL FOUNDATIONS

Diplomatic Relations and Cross-border Business Activities

Diplomatic relations between national governments form an important interaction between home and host institutions that sets the stage for private investment between countries (Bertrand, Betschinger, & Settles, 2015; Duanmu, 2014; Li, Newenham-Kahindi, Shapiro, & Chen, 2013; Shapiro, Vecino, & Li, 2017; Stopford & Strange, 1993). Diplomatic relations, defined as the alignment of governments' national interests in global affairs between two countries (Gartzke, 1998), are in part grounded in ideological and historical ties (Gao, Wang, & Che, 2017; Makino & Tsang, 2011) but continuously evolve with political events that may in nature be cooperative (e.g., military alliance, economic aid) or conflictual (e.g., military conflicts, economic sanctions).

Country-level empirical evidence suggests that diplomatic relations matter for bilateral trade and foreign direct investment (FDI) flows. For example, although increased political influence of the United

States government in a host country leads to more imports of the host government from the United States (Berger, Easterly, Nunn, & Satyanath, 2013), countries receiving the Dalai Lama at the highest political level have been punished through a reduction of China's imports from those countries (Fuchs & Klann, 2013). In addition, countries that have cooperative diplomatic relations with the United States have been found to attract more FDI from the United States (Nigh, 1985). Exploring a wider range of source countries, Li & Vashchilko (2010) find that, between high-income and low-income countries, military conflicts negatively affect bilateral FDI flows while security alliances contribute to bilateral FDI flows.

These studies have yet to investigate how the impact of diplomatic relations varies across firms. A notable exception is Duanmu (2014), who finds that state-owned enterprises have larger greenfield investments than private firms in countries whose diplomatic relations with the home country are good but whose expropriation risks are high, suggesting that state-owned firms can better leverage diplomatic relations to reduce host-country expropriation risks. Our study advances Duanmu (2014) by employing a network perspective for a more comprehensive understanding of the effect of diplomatic relations on firms' foreign investment decisions and by examining more systematically the different types of firms' political ties at home that affect their benefits from good diplomatic relations.

A Network Perspective of Diplomatic Relations

Granovetter (1973, p. 1360) suggests network theory "as a tool for linking micro and macro levels of sociological theory," specifically to explain macro phenomena that result from underlying networking activities of individuals. In this spirit, we explore how patterns of networks between business and political actors at home and abroad can shape firms' international location decisions.

A network "consists of a set of actors or nodes along with a set of ties of a specified type (such as friendship) that link them" and "the ties interconnect through shared end points to form paths that indirectly link nodes that are not directly tied" (Borgatti & Halgin, 2011, p. 1169). Firms and governments can be viewed as interacting in broad networks in which the home government (and its diplomatic service) is a critical node – or a "referral point" – between firms linked to the home government and the home government's network of international diplomatic relationships. Through our engagement with executives of foreign MNEs in China and of Chinese investors abroad, we observe that some executives frequently interact with staff of embassies and consulates in networking events, and through these events they develop business relationships.[1] Thus diplomatic service actors such as foreign affairs ministries or countries' consulates play a key role in facilitating the establishment of cross-border business networks.

As shown in Figure 1 (which we will elaborate on later), good diplomatic relations between governments serve as a bridge between firms in the home country and political and business actors in the host country. Such a bridge is particularly valuable when it represents a "non-redundant" tie (Borgatti & Halgin, 2011), a situation typical for firms before their entry when they have no presence in the host country and thus no local ties.

We extend network theory to illustrate benefits arising from the diplomatic network for those firms able to access the network. First, the basic function of a network is the flow or distribution of information; networks are considered "pipes" through which information and resources flow from one member to another and thus facilitate information exchange and opportunity recognition (Borgatti & Halgin, 2011; Podolny, 2001). Prior research has highlighted the importance of networks for, for example, job search (Granovetter, 1974), business success of Chinese entrepreneurs (Burt & Burzynska, 2017), and technology acquisition from inward foreign investors (Eapen, 2012). Similarly, the pipe that goes through firms, home governments, and host governments can bring in valuable information on business opportunities in host markets. Amicable diplomatic relationships enable more-intensive interactions of diplomats in embassies or consulates who engage with a variety of stakeholders in the host society and become liaisons facilitating interactions between people and organizations across national borders.

Second, network theory emphasizes that personal networks of actors tend to be transitive: Two parties with a mutual friend are likely to become friends (Granovetter, 1973). Transitivity is thus "a tendency [of] two parties who are connected to a third party [to] form mutual relationships over time" (Batjargal, 2007, p. 998). Transitivity occurs because actors strive to reduce inconsistencies and uncertainties in their relationships. Thus when diplomatic relations are amicable, firms who are able to access home governments and thus the diplomatic networks are more likely to become "friends" of host governments. As a

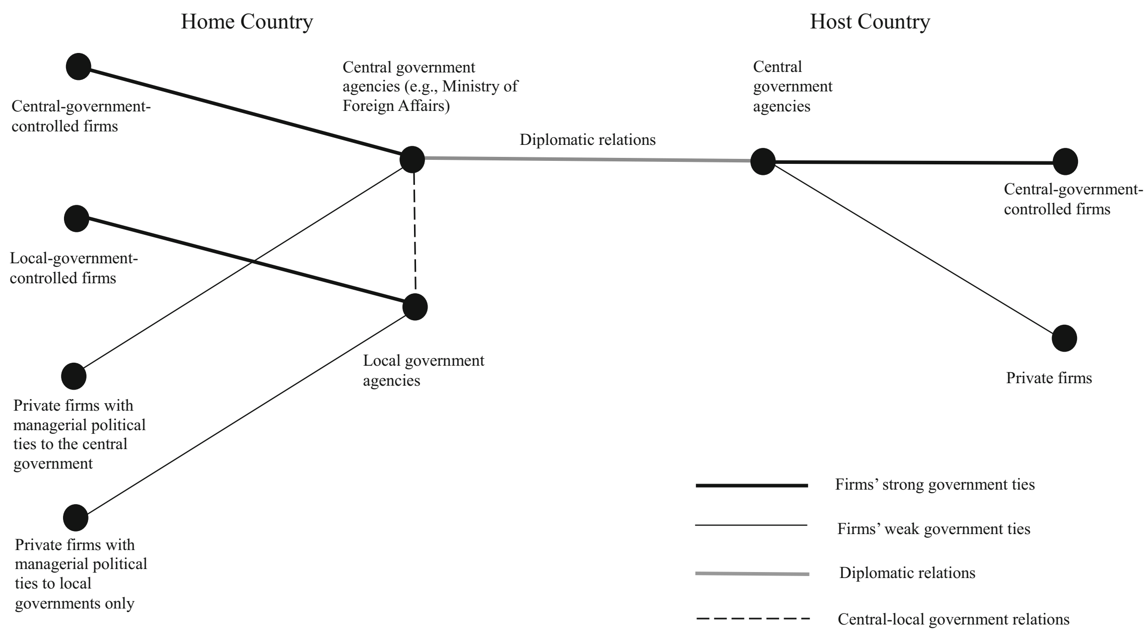

Figure 1 A network view of corporate political connections and diplomatic relations.

result, host governments are less likely to behave opportunistically toward these firms.

Moreover, the transitivity principle also suggests that when home governments enjoy legitimacy in the eyes of host governments as a result of amicable diplomatic relations, firms tied to home governments are likely viewed as legitimate by host governments as well. This is consistent with what Podolny and Page (1998, p. 64) describe: "If an actor's partner in a network form of organization possesses considerable legitimacy or status, then the actor may derive legitimacy or status through the affiliation." Increased legitimacy reduces liability of foreignness and leads to a higher success rate in host countries (Kostova & Zaheer, 1999; Meyer et al., 2014). Legitimacy may also open investment opportunities – for example, when governments grant contracts, licenses, or preferential treatment to firms perceived as more legitimate (Li et al., 2013; Rangan & Drummond, 2004).

Thus when firms are tied to home governments who have good diplomatic connections with host governments, such networks can facilitate investments in at least three ways: by creating information flows, by reducing political risk, and by enhancing legitimacy.

Home Government Ties and the Utilization of Diplomatic Relations

The transitivity concept in network theory (Granovetter, 1973) suggests that tie strength between firms and home governments influences firms' benefits from the diplomatic network. Specifically, transitivity is a function of the strength of dyadic ties in triads (i.e., triples of actors). Let A choose B, and B choose C, then transitivity (A choosing C) is most likely when both ties (A–B and B–C) are strong, least likely when both are weak, and intermediately probable if one is strong and one is weak (Granovetter, 1973). For example, Batjargal (2007) examines entrepreneur–referee–venture capitalist triads and suggests that strong ties between venture capitalists and referees and between referees and entrepreneurs positively influence referrals and investment decisions.

In our setting, transitivity in the form of mutual relationships between firms and host governments is most likely when firms are closely related to home governments *and* when home–host governments have good relations. In other words, when good diplomatic relations are in place, firms that are close to their home government stand to benefit more from these diplomatic relations than those that are loosely or not at all tied to their home government.

The critical question arising from our theoretical discussion is: Which firms have closer ties to home governments? Ties can arise through organizational-level connections such as government ownership or through personal-level linkages involving, for example, members of top management teams serving in political agencies (Sun et al., 2015).

Moreover, both types of connections can be established with high- or low-level governments (Li et al., 2014; Wang et al., 2012; Zheng et al., 2015). Thus among organizational connections with home governments, we distinguish between state-controlled and private firms, where state-controlled firms are defined as those with the government as the largest owner, and private firms as those with a private entity as the largest owner.[2] Among state-controlled firms, we further recognize the difference between central- and local-government-controlled firms. Among private firms, we investigate the importance of personal connections to political entities at central- or local-government levels. We develop our hypotheses in the next section.

HYPOTHESIS DEVELOPMENT

As shown in Figure 1, the baseline proposition for our hypotheses is that firms that have strong government ties at home, especially ties to central governments of the home country, are more likely to connect to the diplomatic networks and thus connect the "pipes" of domestic and diplomatic ties to reach potential host countries. Thus both the strength of a firm's home government ties and the length of the chain of ties from the firm to the diplomatic service determine the firm's ability to access and leverage diplomatic networks.

State-controlled Versus Private Firms

An important channel for strong ties to government is state control (Bruton, Peng, Ahlstrom, Stan, & Kehan, 2015; Sun et al., 2015). Governmental control aligns the strategic goals between firms and governments such that governments provide firms with critical resources in exchange for firms' support of governments' strategic objectives (Sun et al., 2015; Zhou, Gao, & Zhao, 2017). Granovetter (1973) suggests that the strength of a tie is partially a function of reciprocal services which characterize the tie. Thus state-controlled firms, because of their reciprocal relationships with the government, are more closely tied to the government than private firms, which facilitates information and resource access and risk taking. Not surprisingly, recent studies show that state-controlled firms conduct more long-term explorative than short-term exploitative natural resource investments overseas (Bass & Chakrabarty, 2014) and tend to tolerate more risk in the choice of investment scale (Duanmu, 2014) and subsidiary ownership level (Pan et al., 2014).

In our context, the critical resource is the access to the diplomatic network attained through organizational ties to the home government. First – as friends of home and, therefore, host governments – state-controlled firms are more likely than private firms to receive earlier and better information, develop business relations, and access or initiate better business deals in host countries.[3] State-controlled firms are also more obliged to attend to deals reached between the home and host governments, regardless of whether home or host government initiates the deals. Li et al. (2013) and Shapiro et al. (2017) find evidence that state-controlled firms from China are the main implementers of economic deals reached at the governmental level in Africa and Latin America.

Second, access to diplomatic channels between countries also protects state-controlled firms from adverse host government interference. On the one hand, state-controlled firms are more likely to receive assistance from diplomatic services of the home country when political conflicts arise in host countries and negotiations become necessary (Buckley, Clegg, Cross, Liu, Voss, & Zheng, 2007; Pan et al., 2014). On the other hand, such interference is less likely because it would have a more damaging effect on intergovernmental relations than if host governments expropriated private firms (Duanmu, 2014).

Third, state-controlled firms tend, more than private firms, to value good diplomatic relations because of extra legitimacy challenges encountered abroad. The ownership linkage to home governments might raise suspicions in the host society about a firm's motivations (Cui & Jiang, 2012; Meyer et al., 2014). For national security reasons, some host governments impose additional regulatory requirements for approval of investments by foreign state-controlled firms (Globerman & Shapiro, 2009; Sauvant, 2010). Prior studies have found that state-controlled firms are less likely than private firms to complete their overseas acquisitions (Wan & Wong, 2009; Zhang, Zhou, & Ebbers, 2011) or take a longer time to complete their acquisitions (Li et al., 2016). Thus the legitimacy-enhancing effects of good diplomatic relations are likely to be particularly valuable to state-controlled firms.

In contrast, private firms typically do not have formal organizational ties to decision makers in government; hence, they have weak access to diplomatic networks. Yet they may also need such home government support less because they are less likely to face discrimination or legitimacy challenges in the host country. These arguments together suggest that the benefits from the diplomatic network are more salient for state-controlled firms than for private firms. Thus we reach the following hypothesis:

Hypothesis 1a: The effect of diplomatic relations on foreign location choice is more positive for state-controlled firms than for private firms.

Central-government-controlled Versus Local-government-controlled Firms

Firms' ability to use ties to access information diminishes with the length of a tie; in other words, the more nodes a firm needs to go through, the less information the firm will receive (Centola & Macy, 2007). State-controlled firms vary in the length of the ties they have to go through to access diplomatic networks. Firms under control of national or central level governments are likely to have relatively short connections to the diplomatic service, which is another branch of the national government. On the other hand, firms under control of governments at subnational levels such as provinces, municipalities, and counties usually have to go through more intermediary nodes in their network to reach diplomats with contacts to potential host countries.

The differences between firms under control of central and local governments have been highlighted in several recent studies. Notably, the benefits that firms can derive from governments are contingent on both the resources of the different levels of governments as well as the strategic alignment between firms and governments (Li et al., 2014; Lu & Ma, 2008; Wang et al., 2012; Zheng et al., 2015). Li et al. (2014), for example, suggest that whereas firms controlled by local governments are less obliged to fulfill the central government's strategic interests, they also have less-privileged access to institutional resources of the central government. Wang et al. (2012) further suggest that the reach and scope of the central government is more international than that of local governments and, thus, the central government has better international capabilities and provides more-privileged information about foreign markets and business contacts.

In our context, firms controlled by local governments likely receive support by the local governments. However, to support their firms accessing diplomatic networks, local governments would normally have to go through some central government agency, which adds an additional referral point and hence makes the tie indirect. Diplomatic relations are – with very few exceptions – the responsibility of the central government that can influence the quality of diplomatic relations through both economic and political tools (e.g., development aid, investment treaties, and trade policies). Thus it is more challenging for firms controlled by local governments to obtain direct access to diplomatic channels.

On the other hand, firms controlled by central governments usually have better access to diplomatic connections for two reasons. First, they engage in reciprocal relationships with the central government, strengthening their ties with the central government (Granovetter, 1973) and obtaining direct access to diplomatic resources maintained by the central government (Li et al., 2014). Second, the shared career paths of officials in the central government and in leadership roles of firms controlled by the central government create strong personal ties within this broader state sector (Brødsgaard, 2012; McGregor, 2010), which further helps central-government-controlled firms to access diplomatic networks. Thus we reach the following hypothesis:

Hypothesis 1b: The effect of diplomatic relations on foreign location choice is more positive for firms controlled by the central government than for those controlled by the local governments.

Managerial Political Connections Among Private Firms

Tie length to the central government's diplomatic service also varies between private firms that have ties to central or local governments. Private firms can establish ties to governments through managerial connections with government officials or political bodies (Hillman et al., 1999; Peng & Luo, 2000). The corporate political strategy literature has well documented in both developed and emerging markets that managerial political ties confer policy information, financial and regulatory resources, and legitimacy, and thus can benefit firms' domestic operations (e.g., Hillman, 2005; Hillman, Keim, & Schuler, 2004; Li & Zhang, 2007; Peng & Luo, 2000; Shaffer, 1995).

Recent studies also confirm the importance of managerial political connections at home in facilitating firms' internationalization initiatives. Pan et al. (2014) find that although (from a transaction cost perspective) firms favor higher levels of subsidiary ownership in host countries with better institutional environments, political connections at home make firms less sensitive to host-country institutional environments. With stronger political capital, they can better access policy information and resources, leading to a higher level of risk tolerance (Pan et al., 2014). Ma et al. (2016) further suggest that managerial political ties with local governments in China improve entrepreneurial firms' information and knowledge about local institutions at home, thus facilitating their exploitation of these advantages for internationalization.

Our connected networks perspective pushes these arguments further by suggesting that managers' ties to political actors at home can help access the diplomatic service, leading to various benefits in potential host countries. First, managers with political ties are in a better position to access business-relevant information exchanged through diplomatic channels and to secure investment deals with the support of both home and host governments. As a result, these firms likely achieve first-mover advantages abroad (Frynas, Mellahi, & Pigman, 2006).

Second, managerial political ties can confer legitimacy and status to firms, leading to better access to intergovernmental business deals. In fact, business leaders who are well connected politically are commonly part of business delegations accompanying political leaders in state visits, and their companies are likely to strike deals during the visits.[4] State visit participation also creates indirect benefits such as enhanced legitimacy, leading to future investment opportunities in host countries.

Third, firms with managerial political ties can better mobilize home government connections to deal with political hazards in the host country. Frynas et al. (2006) present rich case evidence of Shell, British Petroleum, Volkswagen, and Lockheed Martin, showing that, by leveraging their political connections at home and their governments' connections with host governments, they overcame regulatory barriers and became historical first movers in certain industries in Nigeria, China, and Russia. Moreover, firms may also develop political connections with host governments, with home governments as the referral, which helps to deal with regulatory changes later on.

In the context of China, private firms can establish managerial political ties by recruiting individuals with working experience in government entities into top management or board roles, or recruiting those who served or currently serve in the main political councils in China (Fan, Wong, & Zhang, 2007; Pan et al., 2014; Zheng et al., 2015). Most publicly listed companies in China have such managerial political ties, but only some have such ties to the central government, whereas others have ties to local governments only. Similar to our earlier arguments, we view managerial political connections to central governments as providing better, more direct access to diplomatic networks. On the other hand, ties to local governments may help firms access local resources but are less effective in reaching beyond the country. Formally, we expect the following hypothesis:

> **Hypothesis 1c:** The effect of diplomatic relations on foreign location choice is more positive for private firms with managerial political ties to the central government than for those with managerial political ties to local governments only.

Organizational-level Versus Personal-level Political Connections

An intriguing question is whether organizational-level ties (e.g., state control) or personal-level ties of individual managers are more powerful in creating benefits for firms.[5] Theoretical considerations suggest that organizational-level political ties are qualitatively different from managerial political ties in that the former create organizational embeddedness whereas the latter create personal embeddedness. Sun et al. (2015, p. 1040) argue that "personal-level embeddedness emphasizes the exchange of particularistic favors between economic and political agents, so that organizations can obtain requisite resources from political actors whose personal as well as organizational interests have been advanced by the social elite networks." In contrast, organizational embeddedness "emphasizes the alignment of strategic goals between firms and political institutions," so that the government provides firms with resource support in exchange for firms' accommodation of the government's objectives (Sun et al., 2015, p. 1040).

Applying these ideas to our research question suggests that the organizational embeddedness of state-controlled firms is more likely than managerial political ties to create sustained interfaces with the diplomatic branch of government, for several reasons. First, state control entails a formal obligation of government support, whereas managerial political ties do not entail formal obligations but imply personal favors by government agents.

Moreover, at times of conflicts in host countries, home governments are more inclined to offer assistance to state-controlled firms.

Second, organizational-level political ties likely provide a more stable network of home government connections regardless of who are the individual government or corporate leaders, whereas managerial political ties may be less stable: When people change – both in government and corporate leadership roles – firms may lose these connections (Sun et al., 2015). In some cases, an individual being out of favor could hit the company negatively in terms of reputation, business opportunities, or stock market price (Siegel, 2007; Sun et al., 2015). Moreover, organizational-level political ties are more visible to host governments than managerial political ties and thus more likely to create legitimacy spillovers from home governments. To test these arguments, we focus on political ties to the central government, which we argued above bring more benefits to firms in utilizing the diplomatic relations. Comparing the impact of organizational and personal political connections at the level of central government leads to the following hypothesis:

> **Hypothesis 2:** The effect of diplomatic relations on foreign location choice is more positive for central-government-controlled firms than for private firms with managerial political ties to the central government.

Impartiality of Host Institutions

Firms can benefit from access to diplomatic networks, yet such access may not be equally useful for all potential host countries. Foreign investors generally prefer to invest in countries that offer a "level playing field" without differential treatment of foreign and local firms and where governments do not discretionarily intervene in matters of business (Bevan, Estrin, & Meyer, 2004; Globerman & Shapiro, 2003; Henisz, 2000). Ideally, such a level playing field would be secured by institutions that enforce strict impartiality among different market participants (Rothstein & Teorell, 2008). For example, incorruptible and independent courts enforce the law vis-à-vis units of government to ensure that government agents cannot intervene to favor one company over another. However, in some institutional environments, government–business interactions lack transparency and governments intervene in the business sphere frequently and discretionarily (i.e., related to specific firms) (La Porta, Lopez-de-Silanes, & Shleifer, 2008). The less an institutional environment is characterized by impartiality – that is, equality before the law and regulators – the more often politically connected firms can exploit diplomatic relationships to their advantage.

Specifically, in countries without impartial institutions, foreign investors are likely to be at a competitive disadvantage compared to well-connected local firms: The likelihood of government intervention to protect local firms is higher, and the treatment of foreign firms is more likely to depend on non-economic considerations such as country of origin. Governments and other local players might thus discriminate among investors by hindering some and granting favors to others. In such contexts, foreign firms with strong political ties at home can use diplomatic channels to build connections with host governments and, thus, to attain more-favorable treatment and to lower the risk of adverse political actions (Frynas et al., 2006).

With enhanced impartiality of institutions, however, the ability of governments to discriminate between different investors is reduced. This implies that governments are not as able to hand out favors, but it also means that discrimination not based on law but on (for example) perceptions of the country of origin or the nature of certain types of firms is less likely (Meyer et al., 2014). Thus with more-equal treatment before the law and before regulators, the benefits firms can generate from the diplomatic channels connecting them to the host government are much reduced.

We suggested earlier that the effect of diplomatic relations on foreign location choice is more positive for state-controlled firms than for private firms (Hypothesis 1a), for central-government-controlled firms than for local-government-controlled firms (Hypothesis 1b), and for private firms with managerial political ties to the central (versus local) government (Hypothesis 1c). Putting these arguments together, we expect the advantage that accrues to firms with stronger political connections to be weaker when they target host countries with strong impartiality of institutions. We thus reach the following, three-way interaction hypotheses:

> **Hypothesis 3a:** The less impartial the institutions of the host country, the stronger will be the effect of diplomatic relations on foreign location choice for state-controlled firms over private firms.

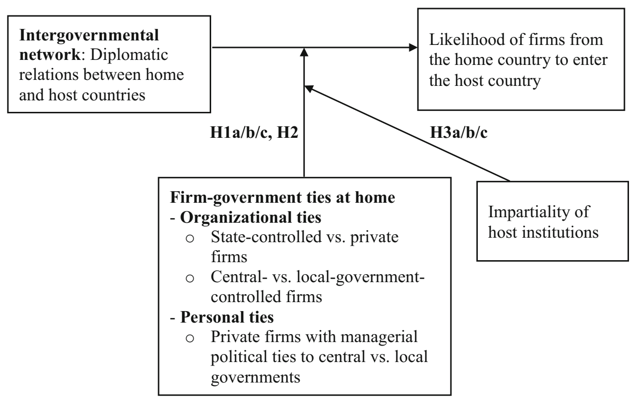

Figure 2 Diplomatic and corporate networks and firms' foreign location choice.

Hypothesis 3b: The less impartial the institutions of the host country, the stronger will be the effect of diplomatic relations on foreign location choice for central-government-controlled firms over local-government-controlled firms.

Hypothesis 3c: The less impartial the institutions of the host country, the stronger will be the effect of diplomatic relations on foreign location choice for private firms with managerial political ties to the central government over private firms with managerial political ties to local governments only.

Figure 2 summarizes the theoretical framework on diplomatic relations between countries and firms' foreign location choice, incorporating the moderating effects of political connections of firms to the home government and impartial institutions of the host country.

METHODOLOGY

Data and Sample

To test our hypotheses, we need a sample of firms varying substantially in the strength of their political ties and whose country of origin is not held in uniformly high regard among potential host countries. Chinese firms represent an appropriate sample. First, they encompass substantive numbers of both private and state-controlled firms, with the latter enjoying close connections to government decision makers. Second, the respect that China and Chinese enterprises enjoy varies greatly around the world. China's rise is viewed by some countries as peaceful but by others as a threat that might challenge the existing order (Womack, 2015). As a result, tensions are acute in East Asia and in relations between China and the United States (Womack, 2015). Similarly, Chinese investments have received mixed welcomes across the globe; they have been generally welcomed in many African countries (Li et al., 2013; Stevens & Newenham-Kahindi, 2017) but triggered nationwide debates and new laws and regulations in North America (Wan and Wong, 2009).

We constructed our dataset of foreign subsidiary locations of Chinese companies listed in the Shanghai and Shenzhen Stock Exchanges, the two major stock exchanges in China. Overseas investment information of Chinese-listed companies has been frequently used in previous IB and strategy research (Liang et al., 2015; Pan et al., 2014; Xia et al., 2014). We first collected from companies' 2014 annual reports information on their foreign subsidiaries. Chinese-listed firms are required to disclose location information on subsidiaries, domestic as well as overseas. We then traced in the annual reports the year of establishment for each subsidiary as well as other data associated with that point in time. We excluded subsidiaries in Hong Kong, Macau, and the tax havens of the British Virgin Islands and the Cayman Islands because they serve primarily as holding organizations or as financing instruments for operations in third countries, or in China itself (Ding, Nowak, & Zhang, 2010), and hence fall outside the scope of our research.

We complemented the information from the annual reports with financial and governance data from the China Stock Market and Accounting Research Database (CSMAR), developed by Shenzhen GTA Information Technology Company – a leading data provider in China. CSMAR has been frequently used in prior research studies (e.g., Fan et al., 2007). Financial data include total assets and net income of companies, and governance data include the identity of the largest shareholder (whether state controlled or private, and whether controlled by central or local governments), shareholding percentage of the top 10 shareholders, and background information of the companies' top managers and board members. We further incorporated various host country and bilateral country information as reported below. As a result, our final sample consists of 1,432 overseas subsidiaries of 516 publicly listed companies in China established from 2003 to 2014 (see the country distribution in the Appendix).

Model Specification

We model the location choice of Chinese-listed firms using a conditional logit (C-Logit) model as described by McFadden (1974) that has been used extensively in location choice studies (e.g., Alcácer & Chung, 2014; Belderbos, Olffen, & Zou, 2011). The underlying assumption is that the location choice of Chinese firms is determined by a set of host country characteristics, including the host country's diplomatic relationship with China and host country institutions, the main variables of interests, as well as other attributes of the host country (specified as control variables below). Specifically, we estimate the following equation:

$$\Pr\left(Y_{sjt} = 1 | X_{jt-1}, W_{jt-1}, \sum_{j=1}^{J} Y_{sjt} = 1\right) = \frac{\Pr\left(Y_{sjt} = 1, \sum_{l \neq j} Y_{slt} = 0) | \mathbf{X}_{jt-1}, W_{jt-1}\right)}{\Pr\left(\sum_{j=1}^{J} Y_{sjt} = 1 | \mathrm{X}_{jt-1}, W_{jt-1}\right)} = \frac{\exp\{\beta_1 X_{jt-1} + \beta_2 W_{jt-1}\}}{\sum_{j=1}^{J} \exp\{\beta_1 X_{jt-1} + \beta_2 W_{jt-1}\}}, \quad (1)$$

where Pr (Y_{sjt} = 1) is the likelihood that at year t a firm establishes a subsidiary s in the host country j rather than other choice candidates; X_{jt-1} is a vector of host country characteristics at year $t-1$; and W_{jt-1} refers to the interaction between diplomatic relations and impartiality of host institutions. Our C-Logit model is based on the assumption that for any fixed s, $\sum_j Y_{sjt} = 1$. In other words, among J countries at year t, subsidiary s is located in only one out of the J countries. To deal with possible reverse causality issues, we used a one-year time lag between the dependent variable and the explanatory variables.

One issue associated with C-Logit models is important to note. Because the C-Logit model focuses on location traits rather than firm traits, firm attributes would be invariant within a choice set and not be used in the estimation (see Eq. 1). A common method to test the effect of firm traits is to split the sample into subsamples according to specific firm traits and compare the effects across subsamples (Alcácer & Chung, 2014). As in our supplementary analysis, we also use Mixed Logistics Regression (MLR) models to deal with the disadvantages of C-Logit models and we find consistent results.

Variables and Measurements

Dependent Variable

Our dependent variable is the probability that a Chinese firm would establish a foreign subsidiary in a specific location from the choice set. Because our sample subsidiaries are located in 56 countries, we consider these 56 countries constituting the relevant set of location choice for Chinese firms in their outward investments. We assign a value of 1 to the chosen country and 0 to all other countries in the choice set.

Explanatory Variables

We measure the quality of diplomatic relations between China and the host country by the affinity of the two countries' votes in the United Nations (UN) General Assembly in the year before the subsidiary's establishment. The data on affinity of UN votes are from Strezhnev and Voeten (2013). It is measured by $1 - 2 \times d/d_{\max}$, where d is the sum of metric distances between votes by dyad members in a given year and $d_{\max}$ is the largest possible metric distance for those votes (Signorino & Ritter, 1999). This measure uses two category vote data (1 = "yes" or approval for an issue; 2 = "no" or disapproval for an issue) and ranges from −1 (least similar interests) to 1 (most similar interests).

The UN General Assembly demonstrates the public stance on a large number of issues, including military, security, social, political, and economic concerns (Voeten, 2000). Voting at the general assembly does not bind countries and thus countries are relatively free to express their sincere opinions (Gartzke, 1998). Countries voting similarly are expected to have a good relationship and act cooperatively because they share similar views and understanding on world issues (Gartzke, 1998). Thus affinity of UN votes has been frequently used to capture interstate political relations in political science and international strategy research (e.g., Bertrand et al., 2015; Desbordes, 2010; Duanmu, 2014; Knill, Lee, & Mauck, 2012).

Moreover, this measure can to some extent alleviate potential reverse causality concerns. Diverse issues are discussed at the general assembly, and so voting decisions are unlikely to be shaped by corporate interests in a foreign country. Nonetheless, in supplementary tests, we used instrumental variable (two-stage least square) estimations to deal with potential reverse causality issues (Baum, 2006).

For state control, we follow earlier studies (Ding, Zhang, & Zhang, 2008; Meyer et al., 2014) to use the principle of the largest shareholder to define a firm as state controlled if the largest shareholder is a government department or another state-controlled firm, and as private if it is an individual or a private company. This definition is based on the observation that, at least in the Chinese context, government entities have a controlling influence even as minority shareholders as long as no other shareholder holds a larger stake.[6]

Among state-controlled firms, we distinguish between those owned by the central government and those by a local government according to whether the controlling entity is at the national level or at the provincial, municipal, or county government level. Chinese-listed companies are required to disclose detailed information regarding the identity of their large shareholders, and the information is from CSMAR.

Based on the background information of top officers in a company from CSMAR, we consider private firms to have managerial political ties when at least one member of the top management team or corporate board worked in a government agency or served or is currently serving on one of the two political councils of China (that is, the Chinese People's Congress [CPC] or the committee of the Chinese People's Political Consultative Conference [CPPCC]) (Faccio, 2006; Liang et al., 2015; Pan et al., 2014; Sun, Mellahi, & Wright, 2012; Zheng et al., 2015). As expected, we find that all private firms in our sample have managerial political ties. This is largely because all Chinese firms were state owned before the economic reforms and China's stock markets were established to reform former state-owned firms. In our sample, we consider firms to have *managerial political ties to the central government* when at least one member of the top management team or corporate board (1) worked in a national-level government agency or (2) served or is currently serving on a political council at the national level. We consider firms to have *managerial political ties to local governments only* when they have no managerial political ties to the central government and when at least one member of the top management team or corporate board (1) worked in a government agency at the provincial or lower level or (2) served or is currently serving on a political council at the provincial or lower level.

We use the Law and Order dimension in the International Country Risk Guide (ICRG) database, published by Political Risk Services (PRS), to capture *impartiality of host institutions*. This measure assesses the strength and impartiality of the legal system as well as the popular observance of the law. The ICRG indicators have been extensively used to measure quality of institutional environments in management research (e.g., Jandhyala, 2013).

Control Variables

We control for several host country factors that likely affect a firm's location choice. First, using patent data from the OECD Patent Statistics, we include *host technology* to capture the host country's level of technological resources, measured by a country's annual number of patent applications to the United States Patent and Trademark Office divided by the country's GDP (Buckley et al., 2007; Kogut & Chang, 1991). Host technology may attract firms to invest with the goal to seek strategic assets (Chung & Alcácer, 2002).

Second, using data from the World Bank, we measure *host natural resources* by a country's total natural resources rents, which is the sum of rents from oil, natural gas, coal, minerals, and forest, as a percentage of the country's GDP. Rich natural resources presumably attract more firms to invest (Buckley et al., 2007; Dunning, 1998).

We also introduce several variables to control for the impact of bilateral relations and distances. We capture bilateral economic relations using three measures: (1) *bilateral trade* is the ratio of the value of export and import between China and the host country to China's total export and import with the world; (2) *bilateral investment treaty* is a dummy variable, coded as 1 if a bilateral investment treaty between China and the host country was in force before the establishment of the focal subsidiary and as 0 otherwise; and (3) *free trade agreement* is a dummy variable, coded as 1 if a free trade agreement between China and the host country was in force before the establishment of the focal subsidiary and as 0 otherwise. The data on the first two measures are from the UN Comtrade database and International Investment Agreement (IIA) database, maintained by the United Nations Conference on Trade and Development. The data on the third measure are from the website of Ministry of Commerce, People's Republic of China. Trade and investment agreements may facilitate investments and help firms deal with the liability of foreignness in overseas markets.

We also include the *geographic distance* between Beijing and the host country as control variables, using data from the CEPII database (Mayer &

Zignago, 2011) and the Kogut and Singh's (1988) cultural distance measure. Geographic and cultural distances likely discourage firms from making investment commitments due to unfamiliarity with the market (Ghemawat, 2001; Shenkar, 2001).

Because friendly relations between municipal governments of different countries may also facilitate investment decisions of Chinese companies, we control for the number of *sister cities* between China and a host country. This variable is operationalized as the log of (1 + number of sister cities). Finally, we control for the parent company's *host country experience*, which can help firms deal with the liability of foreignness in the host market (Delios & Beamish, 2001). Host country experience is a dummy variable, coded as 1 if a firm had subsidiaries in a country prior to the establishment of the focal subsidiary and as 0 otherwise.

RESULTS

Table 1 presents the descriptive statistics and correlation matrix for the variables used in the sample. The results of the variance inflation factor (VIF) test in Table 1 suggest that all VIF values are below 4.0 and, hence, below the recommended benchmark of 10; thus, multicollinearity is not a problem in our analysis (Chatterjee, Hadi, & Price, 2000).

Table 2 reports the C-Logit estimation results for Hypotheses 1 and 2. Model 1 includes the control variables only. Model 2 adds the main effect of *diplomatic relations*. Models 3 and 4 examine the effects in the subsamples of state-controlled and private firms. Models 5 and 6 focus on the results in the subsamples with central-government-controlled and local-government-controlled firms. Models 7 and 8 display the results of private firms – those with managerial political ties to respectively the central government and the local government only. To facilitate the interpretation of the results, we also report the odds ratios and p-values for all coefficients, as recommended by Meyer, van Witteloostuijn, and Beugelsdijk (2017).

Hypothesis 1a predicts that the effect of diplomatic relations on firm location choice is more positive for a state-controlled firm than for a private firm. In Model 3, the coefficient estimate for *diplomatic relations* is statistically significant and positive (b = 0.644; p = 0.001), suggesting that a state-controlled firm tends to choose a friendly (versus hostile) host country. In contrast, Model 4 shows an insignificant coefficient estimate for *diplomatic relations*, indicating that private firms do not have a strong preference over diplomatically friendly locations in their international investments. Furthermore, a Wald test of the difference between the two coefficient estimates for *diplomatic relations* in Models 3 and 4 shows a significant difference between them (χ^2 = 4.31; p = 0.038). These results combined together lend support to Hypothesis 1a; that is, state-controlled firms are more inclined than private firms to invest in host countries with which their home country has good diplomatic relations. The odds ratio in Model 3 indicates that, for state-controlled firms, a standard deviation increase in *diplomatic relations* would make the host country 74% more attractive.[7]

Hypothesis 1b suggests that the effect of diplomatic relations on firm location choice is more positive for firms controlled by the central government than for those controlled by local governments. In Model 5, the coefficient estimate for *diplomatic relations* is statistically significant and positive (b = 0.998; p = 0.001), suggesting that central-government-controlled firms are more likely to invest in countries with good (versus bad) diplomatic relations. The odds ratio in Model 5 indicates that, for central-government-controlled firms, a standard deviation increase in *diplomatic relations* would make the host country 1.06 times more attractive.[8] In contrast, Model 6 shows that the coefficient estimate for *diplomatic relations* is statistically insignificant in the sample of local-government-controlled firms. A Wald test of the difference of the two coefficient estimates indicates a significant difference between them (χ^2 = 2.82; p = 0.09), meaning that the two groups of state-controlled firms differ in their propensity to invest in friendly host countries, with those controlled by the central government more inclined to invest in friendly countries. Thus Hypothesis 1b is supported.

Hypothesis 1c suggests that the effect of diplomatic relations on firm location choice is more positive for private firms with managerial political ties to the central government than for those with managerial political ties to local governments only. However, the coefficient estimate of *diplomatic relations* is negative in Model 7 and positive in Model 8. Thus we find no evidence to support Hypothesis 1c.

Hypothesis 2 suggests that the effect of diplomatic relations on location choice is more positive for firms controlled by the central government than for private firms with managerial political ties

Table 1 Descriptive statistics and correlation matrix

	Variables	1	2	3	4	5	6	7	8	9	10	11	12
1	Location choice	1											
2	Diplomatic relations	−0.116	1										
3	Impartiality of host institutions	0.054	−0.529	1									
4	Bilateral trade	0.215	−0.563	0.343	1								
5	Host technology	0.121	−0.566	0.325	0.607	1							
6	Host country experience	0.080	−0.081	0.05	0.175	0.126	1						
7	Bilateral investment treaty	−0.087	0.281	−0.316	−0.283	−0.362	−0.088	1					
8	Host natural resources	−0.025	0.328	−0.202	−0.205	−0.376	0.001	0.095	1				
9	Cultural distance	0.026	−0.689	0.599	0.311	0.513	0.010	−0.277	−0.414	1			
10	Sister cities	0.125	−0.572	0.232	0.596	0.760	0.125	−0.433	−0.323	0.473	1		
11	Geographic distance	−0.027	−0.047	−0.179	−0.105	−0.270	−0.053	0.179	−0.032	0.144	−0.211	1	
12	Free trade agreement	0.004	0.246	−0.101	−0.123	0.035	−0.003	−0.099	−0.008	−0.195	0.052	−0.233	1
	Mean	0.02	0.66	4.14	1.29	0.23	0.03	0.62	4.65	2.47	1.90	9.01	0.13
	SD	0.13	0.39	1.30	2.01	0.10	0.17	0.49	7.85	1.54	1.18	0.49	0.34
	VIF	N.A.	2.86	2.27	2.20	3.19	1.04	1.35	1.29	3.35	3.21	1.54	1.21

Notes: $N = 80{,}192$; correlations with absolute values no less than 0.008 are significant at 5%.

to the central government. The coefficient estimate for *diplomatic relations* is statistically significant and positive in Model 5 (b = 0.998; p = 0.001) but insignificant in Model 7. The Wald test result indicates that the difference between the two coefficient estimates is significant (χ^2 = 10.73; p = 0.001), thus supporting Hypothesis 2.

Table 3 includes the interaction between *diplomatic relations* and *impartiality of host institutions* in order to test Hypotheses 3a, 3b, and 3c. Hypothesis 3a predicts that the different propensity of state-controlled and private firms to invest in friendly host countries is more salient, the weaker the impartiality of institutions in the host countries. The coefficient estimate for *diplomatic relations x impartiality of host institutions* is statistically significant and negative (b = −0.687; p = 0.000) in Model 9, but not significant in Model 10, suggesting that state-controlled firms – but not private firms – are more inclined to choose a friendly (versus a hostile) host country as the impartiality of institutions of the host country is weaker. Further, a Wald test of the difference between the two coefficient estimates for the interaction term (*diplomatic relations x impartiality of host institutions*) in Models 9 and 10 is significant (χ^2 = 6.87; p = 0.009). Thus Hypothesis 3a is supported.

Hypothesis 3b suggests that the difference in the propensity to invest in friendly host countries between firms controlled by central governments and local governments is more salient, the weaker the impartiality of institutions of the host country. In Models 11 and 12, the coefficient estimates for *diplomatic relations x impartiality of host institutions* are both statistically significant and negative (b = −0.736, p = 0.012; b = −0.563; p = 0.016), suggesting that both central- and local-government-controlled firms are more inclined to invest in friendly (versus hostile) host countries as the impartiality of host-country institutions is weaker. A Wald test of the difference between the two coefficient estimates in Models 11 and 12 suggests that the

Table 2 Conditional logistic regression results of location choice (testing Hypotheses 1 and 2)

	Model 1	**Model 2**	**Model 3**	**Model 4**	**Model 5**	**Model 6**	**Model 7**	**Model 8**
Samples Variables	Full	Full	State-controlled firms	Private firms	Central-government-controlled firms	Local-government-controlled firms	Private firms with managerial political ties to the central government	Private firms with managerial political ties to local governments only
		0.373	**0.644**	**0.139**	**0.998**	**0.374**	**−0.263**	**0.367**
		(0.123)	(0.195)	(0.160)	(0.310)	(0.257)	(0.249)	(0.210)
		[1.451]	[1.903]	[1.149]	[2.713]	[1.453]	[0.769]	[1.443]
Diplomatic relations		*0.002*	*0.001*	*0.385*	*0.001*	*0.146*	*0.292*	*0.081*
	0.315	**0.342**	**0.420**	**0.276**	**0.341**	**0.502**	**0.249**	**0.286**
	(0.040)	(0.041)	(0.061)	(0.055)	(0.093)	(0.082)	(0.090)	(0.072)
	[1.370]	[1.408]	[1.521]	[1.317]	[1.406]	[1.642]	[1.283]	[1.330]
Impartiality of host institutions	*0.000*	*0.000*	*0.000*	*0.000*	*0.000*	*0.000*	*0.006*	*0.000*
	0.153	**0.182**	**0.133**	**0.214**	**0.200**	**0.074**	**0.203**	**0.216**
	(0.014)	(0.017)	(0.027)	(0.022)	(0.041)	(0.036)	(0.035)	(0.029)
	[1.165]	[1.120]	[1.142]	[1.238]	[1.221]	[1.076]	[1.225]	[1.241]
Bilateral trade	*0.000*	*0.000*	*0.000*	*0.000*	*0.000*	*0.041*	*0.000*	*0.000*
	6.121	**5.929**	**7.359**	**4.898**	**7.172**	**7.754**	**2.125**	**6.825**
	(0.730)	(0.725)	(1.129)	(0.957)	(1.681)	(1.536)	(1.473)	(1.297)
	[455.5]	[375.8]	[1569]	[134.1]	[1302]	[2331]	[8.373]	[920.6]
Host technology	*0.000*	*0.000*	*0.000*	*0.000*	*0.000*	*0.000*	*0.149*	*0.000*
	0.760	**0.760**	**0.793**	**0.674**	**0.616**	**0.845**	**0.940**	**0.426**
	(0.103)	(0.103)	(0.144)	(0.149)	(0.221)	(0.199)	(0.221)	(0.202)
	[2.139]	[2.137]	[2.211]	[1.962]	[1.852]	[2.327]	[2.560]	[1.531]
Host country experience	*0.000*	*0.000*	*0.000*	*0.000*	*0.005*	*0.000*	*0.000*	*0.035*
	−0.518	**−0.570**	**−0.532**	**−0.544**	**−0.533**	**−0.529**	**−0.226**	**−0.727**
Bilateral investment treaty	(0.070)	(0.072)	(0.109)	(0.096)	(0.160)	(0.150)	(0.160)	(0.120)
	[0.596]	[0.565]	[0.587]	[0.580]	[0.587]	[0.589]	[1.021]	[0.994]
	0.000	*0.000*	*0.000*	*0.000*	*0.001*	*0.000*	*0.064*	*0.000*
	0.005	**0.007**	**0.006**	**0.008**	**0.013**	**−0.006**	**0.021**	**−0.006**
	(0.006)	(0.006)	(0.009)	(0.009)	(0.012)	(0.014)	(0.011)	(0.013)
	[1.005]	[1.007]	[1.006]	[1.008]	[1.014]	[0.994]	[0.798]	[0.483]
Host natural resources	*0.396*	*0.235*	*0.523*	*0.342*	*0.279*	*0.669*	*0.160*	*0.657*
	−0.442	**−0.416**	**−0.458**	**−0.370**	**−0.203**	**−0.743**	**−0.430**	**−0.343**
	(0.041)	(0.042)	(0.062)	(0.056)	(0.082)	(0.096)	(0.095)	(0.070)
	[0.643]	[0.659]	[0.632]	[0.691]	[0.816]	[0.476]	[0.651]	[0.709]
Cultural distance	*0.000*	*0.000*	*0.000*	*0.000*	*0.014*	*0.000*	*0.000*	*0.000*
	0.121	**0.155**	**0.170**	**0.129**	**−0.048**	**0.402**	**0.310**	**0.030**
	(0.047)	(0.049)	(0.073)	(0.065)	(0.107)	(0.105)	(0.108)	(0.084)
	[1.128]	[1.168]	[1.186]	[1.138]	[0.953]	[1.495]	[1.363]	[1.031]
Sister cities	*0.010*	*0.001*	*0.020*	*0.048*	*0.650*	*0.000*	*0.004*	*0.719*
	0.210	**0.302**	**0.477**	**0.134**	**0.293**	**0.665**	**−0.145**	**0.322**
	(0.066)	(0.072)	(0.108)	(0.097)	(0.164)	(0.146)	(0.157)	(0.123)
	[1.233]	[1.352]	[1.612]	[1.144]	[1.341]	[1.944]	[0.865]	[1.380]
Geographic distance	*0.001*	*0.000*	*0.000*	*0.165*	*0.074*	*0.000*	*0.356*	*0.009*
	0.178	**0.143**	**0.222**	**0.174**	**0.231**	**0.227**	**0.029**	**0.230**
	(0.096)	(0.096)	(0.148)	(0.127)	(0.216)	(0.205)	(0.221)	(0.158)
	[1.194]	[1.154]	[1.248]	[1.190]	[1.260]	[1.255]	[1.029]	[1.259]
Free trade agreement	*0.063*	*0.135*	*0.134*	*0.171*	*0.286*	*0.268*	*0.897*	*0.145*
No. of observations	80,192	80,192	31,864	48,328	14,168	17,696	17,976	30,352
No. of investments	1,432	1,432	569	863	253	316	321	542
No. of alternative choices	56	56	56	56	56	56	56	56
Pseudo R-square	0.190	0.191	0.151	0.224	0.124	0.183	0.238	0.223
Log likelihood	−4669.6	−4664.9	−1945	−2695.7	−891.9	−1039.5	−984.6	−1695.2
Wald test of the null hypothesis that the coefficient estimates of *diplomatic relations* are the same cross models				Model 3 vs. Model 4 4.31 *0.038*		Model 5 vs. Model 6 2.82 *0.090*	Model 5 vs. Model 7 10.73 *0.001*	

Notes: Coefficient estimates bolded, standard error in parentheses, odds ratio in square brackets, *p*-values in italics.

difference is insignificant (χ^2 = 0.22; p = 0.643). Hence Hypothesis 3b is not supported.

Hypothesis 3c suggests that the weaker the impartiality of host institutions, the more salient will be the difference between private firms with central government ties and those with local government ties only in their propensity to invest in friendly host countries. In Model 13, the coefficient estimate of *diplomatic relations x impartiality of host institutions* is statistically significant and negative (b = −0.661; p = 0.018), suggesting that the weaker the impartiality of institutions is in the host country, the more inclined are private firms with central government ties to invest in countries with good (versus bad) diplomatic relations. In Model 14, however, the coefficient estimate for the same interaction term is significant and positive (b = 0.41; p = 0.064), suggesting that the stronger the level of impartiality of institutions is in the host country, the more inclined are private firms with local government ties to invest in countries with good (versus bad) diplomatic relations. A Wald test of the difference between the two coefficient estimates for the interaction term (*diplomatic relations x impartiality of host institutions*) in Models 13 and 14 suggests that the difference is significant (χ^2 = 7.12; p = 0.008). Thus Hypothesis 3c is supported.

The effects of some of the control variables given in Table 2 are noteworthy. First, the direct effect of *impartiality of host institutions* is, in general, positive and significant, which means a more transparent legal system in the host country attracts more FDI settlements. Second, consistent with our expectations, *host technology* attracts more investments from China and *bilateral trade* with China and *sister cities* facilitates Chinese firms' investments in the host country, while *cultural distance* discourages Chinese investments. Geographic distance does not discourage Chinese investments, especially those from state-controlled firms. Finally, consistent with our expectations, *host country experience* before entering a specific country increases the chances of entry.

Supplementary Analyses

We conduct several supplementary analyses to assess the robustness of our findings. First, we use an alternative estimation model based on MLR to address the disadvantages of C-Logit models so that we are able to directly estimate firm effects and relax the assumption of independence of irrelevant alternatives (IIA) (Basile, Castellani, & Zanfei, 2008; Train, 2003).[9] For example, to test Hypothesis 1a, we estimate the following model:

$$\begin{aligned} logit\left(\Pr\left(Y_{ijt} = 1 | \mathrm{DR}_{jt-1}, \mathrm{SC}_{it-1}, X_{jt-1}, \mathrm{Z}_{it-1}, \alpha_i\right)\right) \\ = \alpha_i + \beta_{DR} DR_{jt-1} + \beta_{SC} SC_{it-1} + \beta_{DR*SC} DR_{jt-1} \\ * SC_{it-1} + \beta_1 X_{jt-1} + \beta_2 Z_{it-1}, \end{aligned} \quad (2)$$

where Y_{ijt} indicates that firm i invests in country j at year t; DR_{jt-1} refers to *diplomatic relations* at year $t-1$; SC_{it-1} refers to whether firm i is state-controlled or not at year $t-1$; X_{jt-1} refers to other host country variables at year $t-1$; and Z_{it-1} includes other firm-level variables such as firm age, firm asset, and return on asset. In addition, year dummies are included to capture year effects. As shown in Eq. (2), we use an interactive term ($DR_{jt-1} \times SC_{it-1}$) to examine whether the impact of diplomatic relations on firms' location choice is stronger for state-controlled firms than for private firms. We also use simulation to further test the results of the interaction effects (Zelner, 2009). We use the same method to test other hypotheses and find results largely consistent with those based on the C-Logit models, lending further support to our hypotheses.

Second, we use instrumental variable (IV), two-stage least square estimations to address potential endogeneity concerns (e.g., diplomatic relations is a function of firms' overseas investments). We use the log value of the number of years that China's diplomatic relations have been established with a specific country as an IV. The information is from the website of Ministry of Foreign Affairs of the People's Republic of China. A historical decision of establishing diplomatic relations likely affects the quality of diplomatic relations later on, but it may not affect firms' current location choice. Empirically, we find evidence that *number of years of diplomatic relations* satisfies the requirements defining an IV. It has a statistically significant and positive effect on our main measure of diplomatic relations, *affinity of UN votes* (p = 0.06). However, it has no significant effect on location choice (p = 0.15) or on the error term from the second stage of regression (p = 0.33). Taken together, these results indicate the relevance and exogeneity of *number of years of diplomatic relations* as an IV.

We then conduct a two-stage least square test. In the first stage, we use an ordinary least square regression model, where the dependent variable is *affinity of UN votes* and the explanatory variables include *number of years of diplomatic relations* and other bilateral variables. We obtain *predicted diplomatic relations* – that is, the predicted value of

Table 3 Conditional logistic regression results of location choice (testing Hypothesis 3)

Samples / Variables	Model 9	Model 10	Model 11	Model 12	Model 13	Model 14	Model 15
	State-controlled firms	Private firms	Central-government-controlled firms	Local-government-controlled firms	Private firms with managerial political ties to the central government	Private firms with managerial political ties to local governments only	Full
Diplomatic relations	**4.101**	**0.145**	**4.674**	**3.217**	**3.096**	**−1.665**	**1.883**
	(0.937)	(0.869)	(1.506)	(1.210)	(1.450)	(1.112)	(0.631)
	[60.39]	[1.156]	[107.1]	[24.96]	[22.11]	[0.189]	[6.574]
	0.000	*0.867*	*0.002*	*0.008*	*0.033*	*0.134*	*0.003*
Diplomatic relations X Impartiality of host institutions	**−0.687**	**−0.001**	**−0.736**	**−0.563**	**−0.661**	**0.410**	**−0.301**
	(0.181)	(0.170)	(0.292)	(0.233)	(0.279)	(0.221)	(0.123)
	[0.503]	[0.999]	[0.4789]	[0.569]	[0.516]	[1.506]	[0.740]
	0.000	*0.994*	*0.012*	*0.016*	*0.018*	*0.064*	*0.014*
Impartiality of host institutions	**0.947**	**0.277**	**0.926**	**0.921**	**0.768**	**−0.026**	**0.573**
	(0.152)	(0.143)	(0.251)	(0.192)	(0.239)	(0.182)	(0.103)
	[2.578]	[1.319]	[2.524]	[2.513]	[2.154]	[0.974]	[1.773]
	0.000	*0.052*	*0.000*	*0.000*	*0.001*	*0.885*	*0.000*
Bilateral trade	**0.151**	**0.214**	**0.214**	**0.091**	**0.228**	**0.210**	**0.190**
	(0.027)	(0.023)	(0.042)	(0.037)	(0.036)	(0.030)	(0.017)
	[1.163]	[1.239]	[1.238]	[1.095]	[1.256]	[1.233]	[1.209]
	0.000	*0.000*	*0.000*	*0.014*	*0.000*	*0.000*	*0.000*
Host technology	**7.501**	**4.898**	**7.349**	**7.826**	**2.206**	**6.732**	**5.974**
	(1.145)	(0.958)	(1.705)	(1.553)	(1.481)	(1.291)	(0.728)
	[1810]	[134.1]	[1553]	[2505]	[9.080]	[839.2]	[393.0]
	0.000	*0.000*	*0.000*	*0.000*	*0.136*	*0.000*	*0.000*
Host country experience	**0.799**	**0.674**	**0.626**	**0.850**	**0.933**	**0.413**	**0.764**
	(0.144)	(0.149)	(0.220)	(0.198)	(0.220)	(0.203)	(0.103)
	[2.223]	[1.963]	[1.871]	[2.341]	[2.543]	[1.511]	[2.148]
	0.000	*0.000*	*0.005*	*0.000*	*0.000*	*0.042*	*0.000*
Bilateral investment treaty	**−0.536**	**−0.544**	**−0.524**	**−0.543**	**−0.227**	**−0.730**	**−0.572**
	(0.110)	(0.096)	(0.161)	(0.151)	(0.162)	(0.120)	(0.072)
	[0.585]	[0.580]	[0.592]	[0.581]	[0.797]	[0.482]	[0.564]
	0.000	*0.000*	*0.001*	*0.000*	*0.163*	*0.000*	*0.000*
Host natural resources	**−0.004**	**0.008**	**0.005**	**−0.016**	**0.017**	**0.002**	**0.003**
	(0.010)	(0.009)	(0.014)	(0.015)	(0.012)	(0.013)	(0.007)
	[0.996]	[1.008]	[1.005]	[0.984]	[1.017]	[1.002]	[1.003]
	0.703	*0.356*	*0.700*	*0.290*	*0.153*	*0.900*	*0.603*
Cultural distance	**−0.448**	**−0.370**	**−0.218**	**−0.716**	**−0.408**	**−0.341**	**−0.412**
	(0.060)	(0.056)	(0.080)	(0.094)	(0.093)	(0.071)	(0.041)
	[0.639]	[0.691]	[0.804]	[0.489]	[0.665]	[0.711]	[0.663]
	0.000	*0.000*	*0.006*	*0.000*	*0.000*	*0.000*	*0.000*
Sister cities	**0.125**	**0.129**	**−0.073**	**0.347**	**0.268**	**0.047**	**0.138**
	(0.073)	(0.066)	(0.105)	(0.106)	(0.108)	(0.085)	(0.049)
	[1.133]	[1.138]	[0.930]	[1.414]	[1.307]	[1.048]	[1.148]
	0.088	*0.050*	*0.489*	*0.001*	*0.013*	*0.583*	*0.005*
Geographic distance	**0.414**	**0.134**	**0.248**	**0.594**	**−0.196**	**0.350**	**0.277**
	(0.107)	(0.098)	(0.162)	(0.146)	(0.156)	(0.126)	(0.072)
	[1.513]	[1.144]	[1.282]	[1.812]	[0.822]	[1.419]	[1.319]
	0.000	*0.168*	*0.126*	*0.000*	*0.208*	*0.006*	*0.000*
Free trade agreement	**0.183**	**0.174**	**0.199**	**0.189**	**−0.016**	**0.249**	**0.126**
	(0.149)	(0.128)	(0.217)	(0.207)	(0.222)	(0.158)	(0.096)
	[1.201]	[1.190]	[1.220]	[1.208]	[0.984]	[1.282]	[1.134]
	0.220	*0.173*	*0.360*	*0.360*	*0.944*	*0.117*	*0.191*
No. of observations	31,864	48,328	14,168	17,696	17,976	30,352	80,192
No. of investments	569	863	253	316	321	542	1,432
No. of alternative choices	56	56	56	56	56	56	56
Pseudo R-square	0.154	0.224	0.127	0.185	0.24	0.224	0.191
Log likelihood	−1937.8	−2695.7	−888.8	−1036.6	−981.7	−1693.5	−4661.9
Improvement in model fit test Comparing with Model	3	4	5	6	7	8	2
Chi-square test of Δ Log likelihood	14.40 *0.00*	0.01 *0.99*	6.20 *0.03*	5.80 *0.04*	5.80 *0.04*	3.40 *0.09*	6.00 *0.03*
Wald test of the null hypothesis that the coefficient estimates of *diplomatic relations x impartiality of host institutions* are the same cross models		Model 9 vs. Model 10 6.87 *0.009*		Model 11 vs. Model 12 0.22 *0.643*		Model 13 vs. Model 14 7.12 *0.008*	

Notes: Coefficient estimates bolded, standard error in parentheses, odds ratio in square brackets, *p*-values in italics.

affinity of UN votes from the first-stage results and include it in the second-stage C-Logit regressions. We find highly consistent results as seen in Tables 2 and 3.

Third, we conduct supplementary analyses to examine more directly the theoretical mechanisms we discussed – that is, reducing political risk, securing investment opportunities, and enhancing firm legitimacy – for the impact of diplomatic relations on firm location choice. If our theoretical mechanisms were in place, we would see the impact of diplomatic relations on firm location choice to be stronger in host countries with high political risk, with more constrained investment opportunities, and with lower legitimacy level enjoyed by firms from the same home country. Specifically, we use "political stability and absence of violence" from the World Bank's World Governance Indicator to measure *host political stability*. It captures perceptions of the likelihood of political instability and/or politically motivated violence, including terrorism (Kaufmann, Kraay, & Mastruzzi, 2007). To capture the availability of investment opportunities in a host country, we develop *host investment and business freedom*, based on information from The Heritage Foundation.

To capture the legitimacy level that firms from a home country enjoy, we develop *number of investments from the same home country*, that is, the number of investment and contract deals by all Chinese firms in a specific host country in the year before a focal firm enters the country. It is possible that the more frequently Chinese firms strike deals in a host country, the higher the legitimacy level they enjoy in that country. Such information is from the China Global Investment Tracker, developed by The American Enterprise Institute and The Heritage Foundation.

Our results are consistent with our expectations. Specifically, using C-Logit models in the full sample, we find that the coefficient estimates of the three interaction terms – *diplomatic relations x host political stability*, *diplomatic relations x host investment and business freedom*, and *diplomatic relations x number of investments from the same home country* – are significant and negative, thus providing evidence to support the theoretical mechanisms by which diplomatic relations affect foreign investment decisions.

Finally, most investments in our sample (1022 out of 1432) are unique investments in terms of firm, host country, and year, and we have companies that have more than one investment in the same country and year. Thus we also use negative binomial models to explore determinants of the number of investments by firm, host country, and year. We find similar patterns of results. Thus diplomatic relations affect not only the likelihood of investing in a specific country but also the number of investments in a specific country. All supplementary test results are available upon request.

DISCUSSION

Our study departs from the literature on the geography of firms' international investments (Beugelsdijk and Mudambi, 2013) by not focusing on geographic, institutional, or cultural communalities but rather investigating ties that bind countries even across large distances. Specifically, we examine the role of country-to-country diplomatic relations. Insights from this study contribute to several lines of IB research, which we discuss after reporting some supplementary qualitative investigations.

Illustrative Examples from Participant Observation

To gain a deeper understanding of how and why network relationships between businesses and diplomats matter, we engaged in participant observation research in parallel to conducting our empirical analysis. One of the authors, Klaus Meyer, joined a visit by the Chinese Consul General to Hamburg to the German port city of Wilhelmshaven. First, the delegation visited a local fashion design and brand company, Peine, that had been acquired by Shandong Ruyi, a Chinese state-controlled company, a year earlier. The presentations and company tour were joined by two dozen Chinese-born entrepreneurs resident in Germany who sought contacts with each other, the consulate, and the investor. Second, the delegation visited the container port facilities, where they were additionally joined by the mayor of Wilhelmshaven and a dozen executives of local logistics businesses. The formal presentations focused on the development potential of the port and friendship between the people and cities; informal conversation over a buffet lunch focused on the ongoing negotiations with the Chinese (state-owned) shipping company COSCO to add this port to their lines and to build a warehouse near the port. The meetings surrounding the Consul General's visit thus generate numerous contacts between potential business partners.

Klaus Meyer also joined an initiative of the German Chamber of Commerce in West China that aimed to encourage and publicize social engagement of German companies in China.[10] From the outset, the Chamber collaborated with the Germany-based Bertelsmann Stiftung to access expertise and with the German Consulate in Shanghai to enhance visibility and legitimacy of the initiative. The German Consul General along with the author and four other stakeholder representatives formed the jury for a newly created award in 2016 (and again in 2017). The award ceremony was a high-profile event with over four hundred participants, mainly from German-owned businesses. The German Consul General was present throughout the day and engaged in numerous conversations, not only with the leaders of German businesses (including German, Chinese, and third-country nationals), but also with officials from local districts hosting many German companies. The presence of the German Consul General at the event helped attract participants to the event and both directly and indirectly facilitated introductions and conversations among participants.

Network Theory

Our theoretical contribution invokes the idea of networks as pipes connecting different economic and political actors. Firms without a local presence wishing to access the pipe between the diplomatic corps of the home country and the host country governments need to have access to their own country's diplomatic corps. Our investigation of Chinese firms' foreign investment location choice shows that good diplomatic relations do *not* induce *all* firms to invest in friendly countries; rather, diplomatic relations have a positive effect on firms' location choice *only* when they have strong ties to the home government. Thus good diplomatic relations can be exploited for corporate benefits primarily by firms that are politically connected to their home government and thus to the intergovernmental diplomatic networks.

Our application of network theory to IB is the first to examine interactions between micro firm/individual network and macro intergovernmental network on firms' international investment strategy. Studies have shown that country-level connections including immigration links (Rangan & Sengul, 2009), prior colony–colonizer relationships (Ghemawat, 2001), and historical ties (Makino & Tsang, 2011) facilitate bilateral trade and investment. Other studies have shown that firm-level (e.g., Holm, Eriksson, & Johanson, 1996; Tan & Meyer, 2011) or individual-level (e.g., Levin & Barnard, 2013) networks contribute to firms' internationalization. Our study suggests that political ties at both organizational and individual levels enable firms to access intergovernmental diplomatic networks, which facilitate firms' location choice abroad. We thus bring together networks at different levels (country, organizational, and individual) in one study.

Our second contribution to the network literature is our focus on government agencies as referral points that connect firms with diplomatic networks. The network literature has focused largely on firms and "little has been said about the role of public actors" (Rangan, Samii, & van Wassenhove, 2006, p. 748). The network structure that firms are likely to face ahead of establishing a subsidiary (see Figure 1) illustrates that under some conditions, diplomatic networks can create a non-redundant tie to a local host context. Subsequent to the initial entry, investors likely develop their own local ties, but, as our participant observation research illustrates, ties to diplomats are still seen as valuable even when they are no longer non-redundant.

Future research on the network aspects of our contribution might first use insights in network theory (e.g., the principles of brokerage and closure, Burt & Burzynska, 2017) to delve more systematically into the role of public actors including government and non-government organizations in linking firms with international business or political networks that open investment opportunities for firms or help firms deal with challenges overseas. Second, although diplomatic relations are largely built at the country level, development of sister cities and provinces across countries may also contribute to an overall good diplomatic environment between countries and may in fact affect firms' subnational location choice within a host country. Similarly, given our data limitation, we do not test the impact of some firm characteristics such as business group, R&D investment, and human talent on firms' effective use of diplomatic networks, which leaves room for future research.

Finally, our theoretical arguments do not make any assumptions on where within the network of firms and governments the initiative for an investment originates. As a corporate investment by a listed company, the ultimate decision has to be authorized by the top management of the company. However, it is conceivable that a government approaches a firm through its network tie to invest in a project abroad, or in fact for a host government to seek investors in a project – say, an infrastructure project – and use its diplomatic ties to reach out to potential investors. Our theory is consistent with these types of initiatives originating outside the focal firm. However, for both theory development and to derive policy implications, it might be interesting to distinguish corporations reacting to government initiatives from corporations strategically exploiting their government ties.

Types of Government Ties and Their Utility

We extend our understanding of political tie heterogeneity and its impact on firms' benefits from diplomatic relations. Our findings suggest that the extent to which firms extract value from government ties depends on the alignment of firm-government objectives and the resources of the government. Central governments possess more diplomatic resources, and thus we find that organizational ties to central governments are more valuable than those to local governments for firms that leverage diplomatic resources to advance international investments.

Our findings thus reinforce the importance of distinguishing between firms controlled by different levels of governments when examining their overseas investment activities (Li et al., 2014; Ma et al., 2016; Wang et al., 2012). Even among private firms, we find that those with central (versus local) government ties at home are more inclined to enter host countries that are friendly to their home country but have weak rule of law. Thus managerial political connections make these firms less sensitive to risks associated with weak institutions in the host country.

Our study also extends prior discussions of the different impacts of organizational and personal political ties in a domestic setting to an international setting (Sun et al., 2015). We find that organizational-level political ties to central governments allow firms to benefit more from the diplomatic network than do personal-level political ties to central governments. This finding supports our argument that organizational political ties are more powerful and stable because they entail formal obligations of the central government to assist firms in their overseas activities.

A form of political ties that has received special attention in the recent literature is that equity ownership results in hybrid firms with state ownership (Bruton et al., 2015; Estrin, Meyer, Nielsen, & Nielsen, 2016; Inoue, Lazzarini, & Musacchio, 2013; Liang et al., 2015). These firms often face challenges to the legitimacy of their operations in foreign countries, particularly when acquiring local companies in strategically sensitive sectors (Cui & Jiang, 2012; Li et al., 2016; Meyer et al., 2014). We contribute to this literature by showing that investing in countries that have good diplomatic relations with the firms' home countries may mitigate such challenges.

Future research may advance this research agenda by addressing limitations in our study. First, our study has focused on firms that are publicly listed. As a result, all private firms in our sample have managerial political ties to the home government, and thus we can test only the impact of the strength of such ties on firms' benefits from diplomatic relations. Future research may gather data on smaller firms with and without managerial political ties to examine whether the existence of such ties matters in firms' exploitation of the diplomatic network. One might also investigate differences among firms that have ties to different local governments.

Moreover, future research may dig deeper into the patterns and dynamics of diplomatic ties. We use an indirect measure of diplomatic ties that reflects the relative stability of diplomatic relationships over time, while capturing occasional, sharp changes in diplomatic relationships that affect how the countries interact in the UN forums. There are two avenues to take this forward. One may seek to design measures that more closely capture the diplomatic activity and the interactions between businesses and diplomatic missions, for example, by counting the number of people working in the commercial division of the consulates in a given country. Alternatively, future studies may investigate the impact of specific diplomatic events such as state visits based on news-item-related measures. This would allow capturing the impact of short-term movements in diplomatic activity but would also create endogeneity challenges as state visits may occur because investment opportunities have been identified.

Transfer of Political Capabilities

Our study also enhances our understanding of how political capabilities influence firms' interactions with their institutional environments and thus their location choice. Although underdeveloped institutional environments normally discourage foreign investors (Globerman & Shapiro, 2003), recent studies have suggested that developing-country firms are more inclined to invest in foreign countries with poor governance conditions because they are used to operating in such conditions and have developed political capabilities to deal with policy risk (del Sol & Kogan, 2007; Cuervo-Cazurra & Genc, 2008; Holburn & Zelner, 2010). These studies highlight the idea that the institutional similarity helps firms to transfer their political capabilities overseas.

In contrast to this literature, we argue that to exploit political capabilities in a host country, firms first need to build political connections with host governments. Prior to establishing a local base, few potential foreign investors (especially private ones) have deep ties to host governments that help them deal with entry barriers and local corruption. Our study suggests a direct mechanism that allows firms to exploit their home political ties abroad: diplomatic relations. Firms with strong political ties at home can leverage the diplomatic connections of their home government to build ties with the host government, which may facilitate further development of firms' political capabilities in the host country.

Future research may aim to test these alternative explanations. Such research could take a micro focus and investigate cases of firms that develop close ties to host governments, and then trace the origin of these close ties. Alternatively, future studies could use a carefully calibrated sample of host countries that vary on both diplomatic relations and institutional similarity to study the relative importance of these alternative mechanisms.

Implications and Conclusions

Our study shows theoretically and empirically that some firms are able to bridge into distant geographic locations on the back of inter-country diplomatic relationships. Yet these opportunities accrue primarily to firms that are politically well connected at home and that face weak impartiality of institutions abroad. These findings have implications for both policymakers and firms. Home country policymakers can influence the business environment their firms face abroad. Through collaborative activities, they can develop trusting relationships with host country governments that then facilitate corporate activities and give firms an advantage over competitors from third countries.

Firms can use diplomatic ties between countries to their advantage. The contingencies that our study identifies suggest two possible paths of action. First, firms that have connections to government at home can reach out to the country's diplomatic services to extend the scope of their political connections in the host country, whereas firms with weak or no political ties may work on creating ties to policymakers at home that can link them to diplomatic channels. Second, firms might undermine competitors' preferential treatment in a host country by lobbying for institutional development that strengthens the impartiality of institutions and thus creates equal treatment among investors. The second option of lobbying is indirect, but may be more sustainable in the long run.

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NOTES

[1]See discussion section for illustrative examples based on authors' participant observations.

[2]State control is different from ownership ties because the latter also include minority government stakes in private firms. Because state control and private control imply qualitative differences among firms in terms of government influence and government support, mixing the two groups of firms using ownership ties likely disguises their fundamental differences. We thank an anonymous reviewer for raising this issue.

[3]For example, the improved relationship between Iran and Italy sets the stage for state-owned Italian companies to secure deals in Iran (*Reuters*, 2016). Similarly, the strong ties between the Chinese and Brazilian governments set the stage for business

transactions for Chinese state oil companies in Brazil (*Wall Street Journal*, 2009).

[4]For example, the Chinese president's visit to the United Kingdom in 2015 resulted in deals for British Petroleum and Rolls Royce Plc, both politically well connected, with China's state-controlled firms (*Bloomberg*, 2015).

[5]We thank an anonymous reviewer for raising this question.

[6.]In the supplementary analysis shown later, we used the total state shares of the top 10 shareholders as an alternative measure for state control and reached similar results.

[7]This number is calculated as the standard deviation increase times the odds ratio for diplomatic relations in Model 3 (0.39×1.903).

[8]This number is calculated as the standard deviation increase times the odds ratio for diplomatic relations in Model 5 ($0.\ 39 \times 2.713$).

[9]We are indebted to an anonymous reviewer for recommending this method.

[10]See www.morethanamarket.cn for more information about this sequence of events.

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APPENDIX

See Table 4.

Table 4 Country information of overseas subsidiaries of Chinese firms

Country	Number of subsidiaries	Percentage	Diplomatic relation	Country	Number of subsidiaries	Percentage	Diplomatic relation	Country	Number of subsidiaries	Percentage	Diplomatic relation
United States	320	22.35	−0.668	Switzerland	18	1.26	0.518	Czech Republic	4	0.28	0.404
Singapore	149	10.41	0.995	Belgium	14	0.98	0.429	Kenya	3	0.21	0.982
Germany	111	7.75	0.42	Spain	12	0.84	0.962	Peru	3	0.21	0.79
Australia	77	5.38	0.187	Denmark	11	0.77	0.434	Tanzania	3	0.21	0.534
Italy	61	4.26	0.452	Philippines	11	0.77	0.882	Uruguay	3	0.21	0.91
Canada	60	4.19	−0.13	Poland	11	0.77	0.97	Colombia	2	0.14	0.922
Netherlands	60	4.19	0.418	Austria	10	0.70	0.542	Ethiopia	2	0.14	0.996
Japan	59	4.12	0.579	Ghana	9	0.63	0.966	Hungary	2	0.14	0.423
India	53	3.70	0.94	Nigeria	9	0.63	0.989	Israel	2	0.14	−0.646
United Kingdom	35	2.44	0.187	Turkey	9	0.63	0.56	Jordan	2	0.14	0.958
Indonesia	34	2.37	0.98	Pakistan	7	0.49	0.98	Qatar	2	0.14	0.468
Brazil	33	2.30	0.938	Romania	7	0.49	0.979	Saudi Arabia	2	0.14	0.471
Malaysia	30	2.09	0.98	Sweden	7	0.49	0.471	Uganda	2	0.14	0.993
Vietnam	30	2.09	1	Chile	6	0.42	0.87	Argentina	1	0.07	0.876
Thailand	26	1.82	0.962	Finland	6	0.42	0.476	Ecuador	1	0.07	0.964
France	24	1.68	0.3	New Zealand	6	0.42	0.545	Oman	1	0.07	0.98
South Africa	24	1.68	0.961	Panama	6	0.42	0.98	Portugal	1	0.07	0.468
Luxembourg	21	1.47	0.457	Bulgaria	5	0.35	0.438	Zambia	1	0.07	0.979
Mexico	20	1.40	0.884	Bangladesh	4	0.28	0.984	Total	1432	–	100.00

Notes: Diplomatic relations is measured by affinity of UN votes, which ranges from −1 (least similar) to 1 (most similar).

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