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**ESTABLISHED FOREIGN SUBSIDIARIES AND THE RELATIONSHIP BETWEEN:
THE ENVIRONMENT, SATISFACTION AND INVESTMENT INTENTIONS**

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ABSTRACT

This study identified the environmental factors that influence established foreign subsidiaries operating in Australia. In seeking to examine and explain subsidiary development in a location this study sought to test the relationship between the identified environmental factors, satisfaction and future investment intentions. Based on a sample of 356 foreign subsidiaries operating in Australia, a mediated regression model was used to test the relationship. The results showed that overall satisfaction, national institutional environment, and local investment image had a positive predictive effect, while input costs and small market had a negative predictive effect on the relationship with investment intentions. Overall satisfaction as a mediator on the relationship between these factors and investment intentions indicated that national institutional environment, and local investment image had no additional effect on investment intentions beyond their impact on overall satisfaction.

Key-words: Subsidiary development, environment, satisfaction, investment intentions

1 INTRODUCTION

The world economy has seen a significant increase in the flow of Foreign Direct Investment (FDI) monies in the international global economy in the past 25 years. FDI inflows into economies worldwide between 1982 and 2001 went from USD59bn to USD735bn reflecting a twelve-fold growth (UNCTAD, 2002). This has been coupled with an increase in the deregulation of the world economy and the growth of locations especially among emerging economies seeking to attract the FDI dollars. Such growth in FDI has provided challenges both to Multinational Enterprise (MNE) to make effective and efficient use of their world wide subsidiary assets and to both national and regional governments to try and not only attract but maintain and cement these investment flows into their territories.

In the last 20 years MNE subsidiaries have also developed greater independence and self direction from MNE headquarters (Birkinshaw & Hood, 1998a). They have developed their own strengths and ownership advantages which then often feed back into the MNE network (Bartlett & Ghoshal, 1986). In host markets they have moved from traditional roles of marketer and sales outlet for headquarters' products, to strategic positions in the MNE network involved in value adding activities (Taggart, 1998). These include product development, (Birkinshaw & Hood, 1998b), research and development (R&D) centers of excellence (Holm & Pedersen, 2000) and export-oriented facilities (Papanastassiou & Pearce, 1994) supplying regional and global markets on behalf of the MNE network. Such subsidiary roles have significant ramifications for the location that can develop the subsidiary within its domain. Subsidiary development refers to the process through which MNE subsidiaries enhance their resources and capabilities and in doing so add increasing levels of value to the MNC as a whole (Birkinshaw & Hood, 1998a). Long term benefits in the form of employment, capital formation, knowledge and skill transfer, industry clusters, and the earning of export dollars (Lovering, 2003) accrue to locations that can cement and develop the foreign MNE subsidiary operations in its domain while at the same time seeking to avoid potential divestment of such operations. Diverse locations find themselves competing for mobile investment that has resulted in national and regional governments becoming engaged in "location tournaments" outbidding each other in trying to not only attract MNEs to establish 'greenfield' operations within their region, but also just as importantly seeking to retain established operations.

Australia is no exception in this regard. Government web sites (*Invest Australia*, 2005) both at the national and sub-national state level extol the virtues of Australia (including the various States) as a destination for FDI. State governments in Australia have sought to outbid each other to attract foreign MNEs operations into their state and through government assistance packages to prevent MNE subsidiaries from leaving their domain. As a developed economy with a small market and a potentially unattractive distant location, Australia has managed to historically attract significant inflows of FDI (Thorburn, Langdale, & Houghton, 2002) In 2002 Australia recorded FDI inflows of USD14 billion, the highest level on record since the early 1990s (Golub, 2003).

Although there have been a plethora of studies internationally on the initial determinants of inward FDI at the point of entry, studies considering the continued development of operations in foreign markets post the initial entry have received less attention. As Pearce (2001:51) points, "...too much analysis and policy relating to inward investment focuses on short-term issues involving the attraction of new FDI. Not enough attention is paid to the subsequent medium and longer-term concerns of securing a sustained contribution to processes of industrialization and development from the operations established." In the Australian context what research exists considers the point of entry FDI determinants. Studies in the Australian context have looked at FDI from America (Brash, 1966), from Japan (Nicholas, Purcell, Whitwell, & Kimberley, 1996), and an empirical analysis of secondary investment data (Tcha, 2001; Yang, Groenewold, & Tcha, 2000). No studies to the author's knowledge have considered in the Australian context the post entry relationship between established subsidiary operations and the environment in which they operate. This study seeks to redress this lacuna.

It is in this context that we surveyed managers of foreign subsidiaries operating in Australia to gauge their opinion of the environment factors that influenced their perception of the location in which they operated. The study further sought to determine whether subsidiaries managers were satisfied with the environment in which they operated and is satisfaction predictive of future investment intentions within the location. In order to test this relationship, this study borrows from the marketing literature specifically consumer research and applies it to the international business domain in order to investigate the relationship between attributes (factors), satisfaction and future intentions. An understanding of this relationship is important because it provides policy makers with information as to the issues that affect subsidiaries operating in their environment that can be used to redress subsidiary

concerns where they exist.

2 RESEARCH ON SUBSIDIARIES

Theories that explain the internationalisation of the firm and production are well documented. Hymer's (1976) ownership advantages, Buckley and Casson's (1976) internalization approach underpinned by transaction cost economics (Coase, 1937; Williamson, 1975), and location advantages (Dunning, 1993) offered by the market come together in Dunning's Eclectic Paradigm (Dunning, 1993). The resource-based view of the firm (Barney, 1991) assumes firm resources (especially intangible assets) developed over time from inputs of capital and labour are internalized rather than transacted. The behavioral aspect of the firm (Cyert & March, 1963) underlies the Uppsala model (Johanson & Vahlne, 1977) that argues firms gradually increase their commitment to foreign markets as a result of knowledge and experience in international markets. The above theoretical frameworks all lead the MNE to establish worldwide multi-plant subsidiary operations (Casson, 1982) to exploit opportunities and advantages. Seeking to further develop and build upon the existing theories of internationalization, the literature in the area of the relationship between subsidiary operations and host markets continues to grow (Harzing, 2000b; O'Donnell, 2000; Taggart, 1997) Research on foreign subsidiary operations can be delineated along three lines of investigation (Birkinshaw & Hood, 1998a). These are, the relationship between headquarters and subsidiary, the role of the subsidiary and the development and evolution of the subsidiary in the foreign environment in which it operates.

Headquarters – Subsidiary Relationship: Initial research in the early 1980s sought an understanding of the headquarter-subsidiary relationship. The MNE was a hierarchical organization, centrally directed with subsidiaries acting as instruments of the centre whose roles were limited to local sales and manufacturing (Birkinshaw & Hood, 1998a). This was underpinned by transaction cost economics whereby headquarters maintained control by internalizing worldwide operations. Issues of central control and formalization (Gates & Egelhoff, 1986; Hedlund, 1981), and control and co-ordination (Brandt & Hulbert, 1976; Cray, 1984) reflect upon this dyadic relationship between headquarters and subsidiary.

Subsidiary Roles In the mid 1980s the focus of the research moved to consider the role of the subsidiary in explaining MNE operations. The subsidiary was seen as encompassing different roles having multiple relationships with different players both inside and outside the firm (Birkinshaw & Hood, 1998a). The role of the subsidiary was studied in relation to the industry sector in which it operates (Jarillo & Martinez, 1990) the local business environment (Ghoshal & Noria, 1989) and the relationships with other subsidiaries in the MNC network (Gupta & Govindarajan, 1991). The subsidiary becomes the unit of analysis rather than its relationship with headquarters (Birkinshaw & Hood, 1998a). Moving away from MNE operations explained by hierarchical control this line of inquiry sought to explain MNE operations from a transnational, networks and heterarchical perspective (Birkinshaw & Hood, 1998a). A large number of studies sought to provide a typology of subsidiary roles (Bartlett & Ghoshal, 1986; Ghoshal & Noria, 1989; Jarillo & Martinez, 1990). White and Poynter (1984) established one of the first typologies that identified five subsidiary roles. These were marketing satellites, miniature replicas, rationalized manufacturer, product specialist and strategic independents. This typology revealed the incremental development of the subsidiary through the addition of value added activities (Taggart, 1998). Subsidiaries were thus developmentally non-static and underpinned the essence of the third line of inquiry according to Birkinshaw and Hood (1998a) that of subsidiary development.

Subsidiary Development: Subsidiary development refers to the “process over time through which MNE subsidiaries enhance their resources and capabilities and in doing so add increasing levels of value to the MNC as a whole” (Birkinshaw & Hood, 1998a:2). Often the subsidiary is initially set up as a branch plant and then takes on more value adding activities such as manufacturing or research and development (R&D) (Birkinshaw & Hood, 1997). According to Birkinshaw and Hood (1998a) subsidiary development is an important area of investigation and research in that it aids in understanding the growth and evolution of MNE from a centrally controlled organization to one built on networks of internationally dispersed value adding activities. It also helps in our understanding of the growth of the firm and its impact on the local environment in which the subsidiary operates because it draws upon and contributes to the development of the economy of the host country.

3 THE ENVIRONMENT AND THE SUBSIDIARY

Despite subsidiary operations proceeding effectively in a location, location disadvantages emerging in a location may encourage a MNE to seek to move operations. However, such consequences are not inevitable if subsidiary operations can be embedded into the local economy, thus ‘sticking’ to the location (Pearce, 2001). According to Birkinshaw and Hood (1998b), after the initial investment decision has been made to locate in a specific place, MNE subsidiary development in a location develops as a result of three factors.

Head office assignment whereby central worldwide headquarters determine along which trajectory the subsidiary will follow in the future; *subsidiary choice* whereby subsidiary management takes decisions which impact on the subsidiary’s evolution within a location. *Local environmental determinism* suggests that the role of the subsidiary will be dependent upon its functioning and interaction with the opportunities and constraints in the local market. Thus identifying the environmental factors that impact upon subsidiary development is inherently linked to environmental determinism. Despite this, Benito et al (2003:444) argue that there is a lack of research “relating subsidiary development to exogenous factors that are not firm, network and/or industry specific” in comparison to the well established research showing the development of subsidiaries through internal factors such as head office strategy, networks and subsidiary management (Benito et al., 2003).

Benito et al (2003) and Birkinshaw and Hood (1998b) argue that whether a subsidiary is likely to establish itself in a host location is dependent upon the quality of the location advantages offered by the location. Location advantages which have been shown through empirical testing to impact on the initial decision of MNEs to locate in a specific location include availability of resource endowments, proximity to clients, market size, market growth, wage costs, other production costs, transportation costs, political stability, cultural and social factors, host government regulations and taxation policy, agglomeration economies, and developed infrastructure among others (Dunning, 1993).

In terms of repeat investment MNEs prefer to engage in locations where they have prior experience despite less than optimal results (Benito et al., 2003). MNEs that have invested in high value adding activities often find themselves ‘staying put’. Embedding with local institutions, suppliers, and customers, establishing links both formal and informal often

means that firms are not keen to change and are content to maintain operations so long as they maintain competitiveness (Benito et al., 2003). Exiting a location often means suffering costs associated with exiting but also incurring start up costs in a new location which can be substantial (Narula, 2002). This then suggests that where a MNE is satisfied with the environment where its subsidiaries operate, it may be content to stay and keep investing in the location rather than divesting its operations.

4 PREVIOUS STUDIES RELATING REPEAT INVESTMENT

Studies carried out by Birkinshaw and Hood (1997) in Canada and Scotland found that local environmental characteristics factor into the decision to invest in or upgrade a subsidiary. Despite the influence of the local environment on subsidiary development, evidence of the relationship between the two is rather limited (Birkinshaw & Hood, 1998b). In examining MNEs repeat investment within a location, Fuller and Phelps (2004) surveyed companies in the electronics-related sector in Wales and Ireland. They sought to determine the environmental factors that encouraged repeat investment among foreign subsidiaries. They found that traditional cost-based advantages associated with the initial investment decision, such as labour cost, proximity to market, grant assistance and tax incentives (with regard to Ireland) were also important in the decision to repeat and up-grade investment. These factors were considered more important than factors like after-care services (the provision of post investment), agglomeration economies, transport, and communication infrastructure and transport costs. However, Fuller and Phelps (2004) did note this issue required more in-depth analysis considering the qualitative nature of their inquiry.

Consequently, there is an important need to understand and to identify the key environmental factors that impact upon foreign subsidiary development in a location and to determine whether these factors are the same as those factors that attract the initial FDI to a location. Phelps and Fuller (2000) argue that the role of the multinational and its status within a region is closely related to the track record in winning repeat investment.

Despite a plethora of studies investigating the location advantages of the initial foreign direct investment (FDI) decision (Mudambi, 1995; Scaperlanda, Balough, & Lunn, 1983; Tatoglu & Glaister, 1998; Terpstra & Yu, 1988; Woodward, 1992), comparatively little

attention in the literature on FDI has considered the relationship between the operating environment and the established foreign subsidiary post the initial entry (Birkinshaw & Hood, 1998b). Little is known about what environmental factors in a location influence subsidiary development and lead to repeat investment behavior (Fuller & Phelps, 2004).

In light of the preceding discussion this study seeks to address this by:

Q1. identifying and examining the key environmental factors that impact upon established foreign subsidiary operations in Australia.

5 THE RELATIONSHIP BETWEEN ATTRIBUTES SATISFACTION AND FUTURE INTENTIONS

Research in the marketing literature has considered the nature of satisfaction with products or services and its relationship to future intentions of customers (Brady & Robertson, 2001). It has been found that satisfied customers are more likely to re-use or repurchase a product or service and this will ultimately benefit the organization in terms of profitability (Bernhardt, Donthu, & Kennett, 2000).

Satisfaction can be classified into two types. Attribute satisfaction or transaction specific satisfaction refers to the cognitive satisfaction of individual attributes or occurrences. In this case satisfaction is an accumulated evaluation of different specific attributes (Jones & Suh, 2000). In customer marketing for example Westbrook (1981) suggests that satisfaction with a retail establishment may be based upon the separate evaluation and assessment of the salesperson, store environment, products and other factors.

The second type of satisfaction is termed overall satisfaction or cumulative satisfaction and is an aggregation of the experiences gained. In the marketing literature on customer satisfaction overall satisfaction is 'an overall evaluation on the total experience with a good or service over time (Anderson, Fornel, & Lehmann, 1994). McDougall and Levesque (2000) found that perceptions of attributes of a product like service quality influenced peoples feelings of satisfaction with the service which in turn influenced the future purchase behaviour of customers. They thus found that satisfaction mediated the relationship between service quality and future intentions.

Accordingly the purpose of this study adopting a marketing approach and applying it to international business seeks to test empirically the relationship between the environmental factors, satisfaction (with the location) and the future investment intentions among established foreign subsidiaries operating in Australia. Given the preceding discussion, this study seeks to answer the following research questions

- Q2** Is there a significant relationship between the environmental factors identified (see Q1) and future investment intentions of subsidiaries operating in Australia?
- Q3** Is there a significant relationship between the overall satisfaction and future investment intentions of subsidiaries operating in Australia?
- Q4** Does overall satisfaction mediate in a manner the relationship between the environmental factors identified (see Q1) and future investment intentions of subsidiaries operating in Australia?

6 METHOD

Sampling and Data Collection

Participants in the study consisted of managers of foreign MNEs subsidiaries from North America, Europe and Japan, which have established subsidiary operations in Australia. The sampling frame was compiled from the relevant directories of the various foreign Chambers of Commerce that operate in Australia. These directories provided company details that included, the sector of operation, name of the parent company, the name and address of the subsidiary, contact details of the CEO or Senior Executive of the subsidiary to whom the questionnaire was directed. Questionnaires (inclusive of a covering letter and reply paid envelope) were distributed by post in March and April 2004 to 2200 foreign MNEs from North American, European and Japanese subsidiaries operating in Australia. Japanese firms were sent both an English and Japanese version of the questionnaire in an effort to increase the response rate. This was also complemented by follow up phone calls. Two hundred and thirty-six questionnaires were returned as 'unknown address' leaving 1964 eligible respondents. From these 356 questionnaires were returned resulting in a response rate of 18.1%. This was in line and slightly above the typical response rates to be found in studies that have been based

on cross-national mail surveys of industrial populations. In a review of such studies Harzing (2000a) found that response rates typically varied between 6 and 16 %.

Non-response bias was checked by examining the firm attributes of the sample, viz a viz industry and location within Australia that showed no statistical differences between responding and non-responding companies.

7 QUESTIONNAIRE

The questionnaire consisted of three parts. Part 1 asked questions regarding background information that sought to determine the characteristics of the sample. Part 2 and 3 of the questionnaire presented the survey participants with a list of 50 items derived from the literature and studies on locational determinants (Alford, Lussier, & Siebes, 1997; Castro & Buckley, 2000; Ng & Tuan, 2002; Tatoglu & Glaister, 1998). The fifty items were separated into two separate scales. Part 2 consisted of 19 items that asked participants their opinions on Australian national environment in which they operate. Part 3 consisted of 31 items that asked questions from the sub-national environment perspective. The responses were assessed using a 5 point Likert scale with scores ranging for each scale from 1=strongly disagree to 5=strongly agree with 3 being the neutral midpoint.

8 CHARACTERISTICS OF THE SAMPLE

The sample comprised 356 foreign subsidiaries that operate in Australia. The geographic origin of the sample reflects a relatively equal spread among the Triad of economic powers: North American n=124 (34.8%), European n=120 (33.7%) and Japanese n=112 (31.5%). Industry categorization of the sample revealed that firms in primary in manufacturing, wholesale/retail trade and the service industries made up roughly 11%, 27%, 33% and 29 % respectively. The size of the subsidiaries based on the number of employees revealed that the majority of the foreign subsidiaries in the sample operating in Australia are small to medium-sized enterprises (SMEs) (under 200 employees) making up 82% of the sample. Years of operation in Australia were, between 1-10 years 31%, 11-20 years 30%, and over 20 years 37%. More than half (57.9%) of the foreign subsidiaries in the sample were

wholly owned foreign subsidiaries established through new ventures (greenfield investments), approximately 25% were takeovers through the acquisition of local firms and the remaining 16.3% of the sample identified themselves as a joint venture or a merger with an Australian company. The location of the firms in the sample indicate that the overwhelming majority (86.2%) are located in the two largest state economies, NSW and Victoria suggesting the strength of both these states in attracting the bulk of foreign direct investment.

9 RESULTS AND DISCUSSION

9.1 Factor Analysis

A principal axis factor analysis with oblique (promax) rotation was conducted to answer research **Q1**. The underlying relationships among the 50 items in the two scales were examined. The combination of the two scales for the exploratory factor analysis was considered appropriate as the environment under analysis could not be considered mutually exclusive in terms of national or sub-national context.

There were 15 factors (components) with eigenvalues greater than one. Further inspection of the scree plot, supported a 12 factor solution. Ultimately only ten factors were considered appropriate after considering the loadings of the alpha scores and a logical interpretation of the factors (see Table 1). A cut off score of 0.4 was used to determine the items that loaded onto the factors (Hair, Black, Babin, Anderson, & Tatham, 2006). The factors explained 50.2% of the observed variance. The ten environmental factors identified were agglomeration, infrastructure, government support, national institutional environment, local investment image, overall satisfaction, input costs, investment intentions, cost of doing business, and small market. In terms of internal consistency all the measure had an acceptable alpha score ranging from .80 for local investment image to .64 for cost of doing business. Nunnally (1978) suggested that in an exploratory study an alpha value of 0.6 is acceptable in determining the loaded factors.

Table 1 Results of the Factor Analysis for the Operating Environment

Item	1	2	3	4	5	6	7	8	9	10	11	12
The location provides an atmosphere of cooperation among companies in your industry	.72	.000	.000	.000	.000	.000	.000	.000	.000	.000	.000	.000
The location has a concentration of firms in the same or similar industry to yours	.71											
This location allows you to work closely with your suppliers	.59											
The location provides you with the ability to work formally or informally with other firms in your industry	.54											
The competition in this location stimulates entrepreneurial activity	.48											
There is a strong network of business linkages and sharing of industry information in the location	.47											
The location allows you to work closely with your customers	.46											.42
This location has given your firm the opportunity to tap into scientific or technical knowledge	.42											
This location has too many competing firms in your industry	.41											
There is a well developed and accessible local infrastructure		.70										
There is a well developed transport/logistics infrastructure		.66										
The location offers an excellent communications infrastructure		.58										
The State/Regional Investment agency has had a positive impact on your firm			.83									
The state/local government provides a high level of post-investment support			.71									
The national investment agency "Invest Australia" has had a positive impact on your firm			.69									
The Australian Government provides a high level of support post-investment			.46									
Australia is safe place to invest				.68								
Australia overall has a positive investment image				.60								
The economic environment in Australia is conducive to investment				.59								
There exists a stable political climate for investment in Australia				.59								
The local economic environment is conducive to investment					.78							
The investment image of the location is positive					.77							
This location offers a high quality lifestyle					.63							
The overall satisfaction with the decision to invest in Australia						.97						
The overall satisfaction with decision to locate in your present city/regional/rural location						.66						
Overall satisfaction with the financial performance in Australia						.54						
The skilled/professional labour is too expensive							.63					
The unskilled labour is too expensive							.63					
Transport costs are high in this location							.51					
Real estate to buy or rent is expensive in this location							.46					
Does your company intend to invest in Australia in the next 5 years:								.93				
Does your company intend to invest in your present city, regional or rural location, in the next 5 years:								.88				
There is a high level of bureaucratic 'red tape' at the state/local level									.76			
There is a high level of bureaucratic 'red tape' in Australia									.62			
Australian federal taxation levels are too high									.49			
There are low levels of growth in the Australian market for your company										.79		
The Australian market for your firm is too small										.66		
There is a high level of industrial disputation in Australia											.63	
Your firm faces a high level of industrial disputes in this location											.60	
There is adequate market access for your firm in this location												.55
Eigenvalue (pre-rotation)	7.6	4.6	3.1	2.5	2.0	1.8	1.6	1.5	1.5	1.4		
Percentage of variance explained	13.8	8.4	5.6	4.4	3.7	3.3	2.9	2.8	2.7	2.6		
Cronbach Alpha	.79	.70	.79	.76	.80	.73	.67	.90	.64	.73		

1- Agglomeration (Agg), 2- Infrastructure (Inf), 3- Government Support (GS), 4- National Institutional Environment (NIE), 5- Local Investment Image (LII), 6- Overall Satisfaction (OS), 7- Input Costs (IC), 8- Investment Intention (II), 9- Cost of Doing Business (CDB), 10- Small Market (SM)

10 RELATIONSHIPS AMONG THE FACTORS

Table 2 provides the means, standard deviations, and correlations for all the variables. The size of the inter-correlations evident suggest that multi-collinearity should not be a problem in the data set and are large enough not to threaten discriminant validity (Tabachnick & Fidell, 2001). An examination of the mean scores of the ten composite factors reveals that all but one of the factors (i.e. government support) was rated equal to or above the midpoint. The highest mean scores of the sample revealed that the foreign MNE subsidiaries consider favourably the National Institutional Environment in Australia ($M=3.9$). The foreign subsidiaries in the sample saw Australia in a positive light in terms of their continued operations. They recorded both an Overall Satisfaction ($M=3.8$) with their investment in Australia and future Investment Intentions ($M=3.3$). This was in marked contrast to the lowest mean score for the factor Government Support ($M=2.5$) suggesting that foreign MNEs subsidiaries had a negative attitude towards the degree of post investment support being received from government or government agencies in Australia. Other factors worth noting were positive attitudes by the participants towards Infrastructure ($M=3.7$) and the Local Investment Image ($M=3.5$) of the location and negative by the participants to Input Costs ($M=3.3$), and Costs of Doing Business ($M=3.5$). An ambivalent attitude towards the size of the market ($M=3$) in Australia as well as the impact of agglomeration economies ($M=3.2$) was evident among the participants.

Table 2 - Means, Standard Deviations and Correlations Among the Measures of Environmental Factors

Factor	<i>M</i>	<i>SD</i>	1	2	3	4	5	6	7	8	9	10
1	3.2	0.55	--									
2	3.7	0.60	.33**	--								
3	2.5	0.66	.42**	.08	--							
4	3.9	0.57	.05	.25**	.11**	--						
5	3.5	0.69	.24**	.41**	.18**	.41**	--					
6	3.8	0.68	.03	.14**	.07	.38**	.32**	--				
7	3.3	0.62	.20**	.06	-.03	-.23**	-.08	-.27**	--			
8	3.3	0.66	-.01	-.01	.08	.22**	.22**	.37**	-.23**	--		
9	3.5	0.70	.00	.04	-.21**	-.14**	-.11*	-.08	.16**	-.03	--	
10	3.0	1.05	-.13*	.07	-.14**	-.17**	-.18**	-.27**	.16**	-.28**	.10	--

* $p < .05$ ** $p < .01$

1- Agglomeration, 2- Infrastructure, 3- Government Support, 4- National Institutional Environment, 5- Local Investment Image, 6- Overall Satisfaction, 7- Input Costs, 8- Investment Intention, 9- Cost of Doing Business, 10- Small Market

11 MULTIPLE REGRESSION ANALYSIS

11.1 MEASURES

Independent Variables (IV): The independent variables employed in the study were identified in the factor analysis. The constructs are operationalized with several underlying measurement items. The factor analysis undertaken followed the standard procedure in terms of data reduction to develop composite variables. The following environmental factors (IVs) were used in the subsequent multiple regression analysis. These include agglomeration, infrastructure, government support, national institutional environment, local investment image, input costs, cost of doing business, small market and overall satisfaction which had a dual role as an independent and dependent variable.

Dependent Variable (DV): In a similar construction to that described above both overall satisfaction and investment intentions were derived from the factor analysis. Satisfaction and investment intentions were captured using subjective measures. Studies by Brouthers, Brouthers, and Werner (1999) revealed a reluctance by firms to provide financial measure of performance for their subsidiaries. As a result, we employed managerial self-evaluations to measure satisfaction with the environment in which they operate. Subjective measures can be used to proxy for performance against financial and non-financial criteria (Dess & Robinson, 1984). We adopted the approach of asking a number of questions in the survey which sought to capture the survey participants' views regarding their satisfaction with their subsidiary's performance and their future investment intentions in the environment in which they operate.

Control Variables: Five control variables were included in the multiple regression analysis. These related to the geographic origin of the MNE parent (North America and Europe) and the industry of the subsidiary (Primary, Wholesale/Retail and Services). In seeking to control for nuisance variable Breaugh (2005) has argued for legitimate theoretical underpinning of the nuisance or control variables with the variables being tested. International business studies have shown the importance of national origin and its corresponding culture to issues of location and how location and firm specific variables affect the location decision making of manufacturing investment (Chernotsky, 1983; Ulgado, 1996; Ulgado & Lee, 2004)

. In a similar manner the use of industry as a nuisance variable was based on the notion that industry characteristics shape a firm's strategic behaviour which then can influence performance (Porter, 1980). The environment in which an industry operates also influences decisions as to how a firms resources are to be used (Sampler, 1998).

Table 3 Non - mediated and mediated regressions on environmental factors, satisfaction and future investment intentions.

Variables	Investment Intention (Model 1)	Overall Satisfaction (Model 2)	Mediated Model (Model 3)
Independent Variables			
Agglomeration	-.04	.01	-.04
Infrastructure	-.10	-.00	-.10
Government Support	.04	.01	.04
National Institutional Environment.	.12*	.17**	.06
Location Investment Image	.16**	.21***	.10
Input Costs	-.17**	-.16**	-.13*
Cost of Doing Business	.07	-.01	.06
Small Market	-.20***	-.19***	-.15**
Overall Satisfaction			.29***
Control Variables			
Europe	.03	.13*	-.01
North America	-.07	.18**	-.12
Primary	.06	-.06	.07
Wholesale/Retail	.13*	-.05	.14*
Services	.06	-.13*	.09
R ²	.19	.26	.24
Error df	330	331	328

p<.05* p<.01** p<.001***

11.2 MEDIATED REGRESSION METHOD OF ANALYSIS

Mediated multiple regression analysis was used to answer research **Q2, 3 and 4**. The result of which can be seen in Table 3. Listwise deletion was used for missing data resulting in a reduction in the sample from 356 cases to 343. The variables in the regression analysis were hecked for normality, linearity and heteroscedasticity. None of residual scatterplots indicated that these statistical assumptions had been transgressed (Hair et al.,

2006). Baron and Kenny (1986) have stipulated three steps in testing for mediated regression. The control variables were used in all three steps.

Model 1 First we ran a regression with the independent variables (agglomeration, infrastructure, government support, national institutional environment, local investment image, input costs, cost of doing business, small market) predicting the dependent variable (investment intentions). In answering research **Q2**, we found only that national institutional environment, local investment image, input costs and small market were significantly related to investment intentions.

Model 2 Secondly the mediator needs to be related to the IVs (Baron & Kenny, 1986). We tested and found that the mediator (overall satisfaction) was significantly related to the same independent variables as per model 1 i.e. national institutional environment, local investment image, input costs and small market.

Model 3 Thirdly we ran a simultaneous regression with both the independent variables and the mediator (overall satisfaction) predicting the dependent variable (Investment intentions) (Model 3). The mediator (overall satisfaction) as is stipulated required for mediation to occur was significantly related to the dependent variable (investment intentions) (research **Q3**). For mediation to have occurred the strength of the relationship of the independent variables (national institutional environment, local investment image, input costs and small market) to the dependent variable (investment intention) should have decreased (as per the coefficient values) if overall satisfaction is a mediator (compare Models 1 and 3). This occurred (research **Q4**). Full mediation occurs when the mediator completely mediates the relationship between IV and DV as is the case with national institutional environment and local investment image.

They are no longer significant and have been mediated through overall satisfaction (model 3). However partial mediation occurs where the path from the IV to the DV is reduced (i.e. size of the coefficient), however is still significant as is the case with input costs and small market (compare the size of the coefficient in model 1 and 3). In Table 3 we also report the incremental variance explained by overall satisfaction (model 3), where there has been an increase in R^2 equal to .05 ($.24 - .19 = .05$ the difference between model 3 and 1).

13 DISCUSSION AND CONCLUSION

The worldwide growth of dynamic local environments has resulted in locations facing a diminishing ability to influence MNEs which today have many options available to choose from in terms of sites to locate operations (Raines, 2003). Development agencies and government policy makers in order to retain foreign investment and see it develop successfully need to better understand the needs of the foreign investor. The environment in which they operate can have a significant influence on the evolution and success of subsidiaries in specific locations (Benito et al., 2003). Subsidiary development is in part driven by the dynamism of the local business environment in which business operates (Birkinshaw & Hood, 1998b). The operating environment is thus of fundamental importance to the continued operation of foreign subsidiaries.

This study using data from foreign subsidiaries operating in Australia, identified eight environmental factors that can potentially influence established foreign subsidiary operations. These factors were agglomeration, infrastructure, government support, national institutional environment, local investment image, input costs, cost of doing business and small market.

Of these national institutional environment and the location image of operation had a direct positive relationship predicting future investment intentions. These findings confirm the findings of other studies that have addressed the location determinants of attracting initial FDI. The national institutional environment and location image reflect the risks associated with political and economic instability in host environments which act as a deterrent to FDI (Dunning, 1993; Kogut, 1989; Loree & Guisinger, 1995). Agarwal (1980) found a negative correlation between FDI and political instability. Such instability leads investors to believe that a change of national or regional governments may lead to policy changes regarding foreign investments thus causing reluctance to invest in such locations. Loree and Guisinger (1995) showed that the liberalization of national restrictions on inward investment had a significant impact on the foreign involvement of MNEs. Australia in this regard is seen in a positive light having well established institutions, a politically and economically stable environment and a liberal foreign investment regime that continues to encourage and protect foreign investors. However it is important to note that both these factors effect on future

investment intentions was mediated through overall satisfaction suggesting that they had no additional impact on investment intentions beyond their impact on overall satisfaction.

Overall satisfaction was seen to have a direct relationship with future investment intentions. It logically follows that being satisfied with the location's environment in which you operate is likely to lead you to reinvest in that location. Overall satisfaction is a cumulative construct based on all experiences, summing satisfaction (Jones & Suh, 2000).

Although based on consumer research satisfaction of the customer has been found to ultimately determine future intentions and behaviors towards a product or service (McDougall & Levesque, 2000). Jones and Suh (2000) found that overall satisfaction had a direct effect on how likely customers were to re-use a service. This is important in that it indicates that as a cumulative construct overall satisfaction is based on the total experience of the subsidiary operation in the environment in which it operates.

The study also revealed a negative relationship between input costs and small market size in predicting future investment intentions. This confirms Fuller and Phelps (2004) study that found traditional cost-based advantages associated with the initial investment decision, such as labour cost were also important in the decision to repeat and up-grade investment. Minimizing costs in order to increase long term profits act as an inducement for MNEs to locate operations where there are low production costs. Low wages means low production costs making it attractive to MNEs to take advantage of locations offering such conditions.

However the evidence suggesting labour costs are a determining factor in attracting FDI is contradictory. Where Dunning (1980) and Culem (1988) found labour costs did not influence investment decisions among developed countries for developing countries labour cost differentials were found to be a significant determinant of FDI (Wheeler & Mody, 1992).

Market size is considered an important pull factor in terms of determining FDI. Empirical studies (Dunning, 1980; Papanastassiou & Pearce, 1990; Scaperlanda et al., 1983; Woodward, 1992) have shown that the market potential and size of market act as a significant factor in attracting FDI. A larger market provides MNEs with the opportunity to gain greater profits through increased sales and the ability to exploit economies of scale in production. It is interesting to note that both of these factors only partially mediated their effect on future investment intention through overall satisfaction. This suggests a strong direct effect on future investment intentions. This may mean that governments may need to do more to ameliorate the negative factors in order to encourage overall satisfaction.

Although the results are specific to Australia and their generalizability should be treated with caution some observation regarding small market economies can be made. Governments need to create favourable conditions to encourage MNEs to stay within their domain. Policy efforts by governments in small economies can concentrate on creating specific conditions such as a positive institutional environment to encourage investment. In order to combat the small market, small economies need to provide specific advantages or above average advantages not offered by competing locations. Such location advantages may encourage the establishment of export-oriented subsidiaries able to achieve economies of scale and thus keep costs of production low while at the same time not being reliant solely on the small local market.

Although the other factors agglomeration, infrastructure, government support, cost of doing business were not found to have significant relationship with investment intentions, they should also not be discounted in terms of having some impact in terms of the overall satisfaction of the environment in which the subsidiaries operate. Several studies have concluded that locations with these environmental factors help attract FDI. Agglomeration effects (Hogenbirk & Narula, 2004), transport and communication infrastructure effects (Cheng & Kwan, 2000), the role of investment agencies and after care services (Birkinshaw & Hood, 1997), and taxes and charges (Yamada & Yamada, 1996) all were seen as important determinants of FDI.

Adding to previous studies, this empirical study has identified the environmental factors that impact upon established foreign subsidiary operations in a small but developed economy like Australia. The factors identified in the study were agglomeration, infrastructure, government support, national institutional environment, local investment image, input costs, cost of doing business, and small market. Evidence from the study on foreign subsidiaries in Australia suggested subsidiary investment intentions were related positively to overall satisfaction, the national institutional environment and local investment image of the location, while negatively to input costs, and small market.

While this research has provided insight into the relationship between environmental factors satisfaction and future investment intentions, in a small host market, future research is recommended. Subsidiaries vary in terms of origin, industry and sub-location. It seems appropriate that future research investigates whether differences in the relationships investigated can be further delineated on the basis of national origin, industry characteristics and the sub-Location of the subsidiary, allowing for more micro investigation.

Scope exists for the replication of this study in other host markets which can thus add to the contribution made by this study to our understanding of the relationship between established foreign subsidiaries and the host market environment in which they operate.

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