

Stronger together: Country-of-origin agglomeration and multinational enterprise location choice in an adverse institutional environment

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Abstract

Research Summary: Research suggests that multinational enterprises (MNEs) are attracted to locations with concentrated firms from the same home country to benefit from interactions with market forces, but it remains an open question whether such agglomeration facilitates MNEs' interactions with nonmarket actors such as the host government. We submit that since country-of-origin agglomeration can enable collective actions and create collective gains, colocation with compatriot firms will help MNEs navigate an adverse institutional environment. In line with this reasoning, we hypothesize that MNEs are more attracted to locations with country-of-origin agglomeration when MNEs face an exogenous shock that increases their regulatory burden in the host country. Our analysis offers corroborative evidence. The study adds to research on agglomeration, institutional environment, and location strategy.

Managerial Summary: Why do multinational enterprises (MNEs) locate near compatriot firms in a foreign location? The commonly recognized benefits include resource access and knowledge spillover from interactions with market forces such as suppliers and customers. We submit that colocation with compatriot firms can also help MNEs navigate an adverse institutional environment by generating “stronger-together” benefits.

Colocation can enable collective actions and create collective gains for MNEs in their interactions with the host government. We find that after a diplomatic dispute, Korean MNEs are more attracted to locations in China that already have a cluster of Korean firms, whether in the same/related industries or in unrelated industries; this is particularly the case for small MNEs and in locations with weak institutions.

KEYWORDS

collective action, country-of-origin agglomeration, emerging market, institutions, multinational enterprises (MNEs), regulatory burden

1 | INTRODUCTION

Agglomeration is an important consideration when firms expand internationally. Early research focuses on how firms are drawn to locations with clusters of firms in the same industry (e.g., Chung & Alcacer, 2002; Head, Ries, & Swenson, 1995). Recent research shows that multinational enterprises (MNEs) may colocate in a region with other firms from the same country of origin. Following the agglomeration economics literature, this stream of research has highlighted the economic benefits of country-of-origin agglomeration such as resource provision and knowledge spillover that lower transaction costs and improve efficiency in business activities (Chang & Park, 2005; Stallkamp, Pinkham, Schotter, & Buchel, 2018; Zaheer, Lamin, & Subramani, 2009; Zhu, Eden, Miller, Thomas, & Fields, 2012). In addition to such benefits from interacting with market forces such as suppliers, customers, and competitors, country-of-origin agglomeration may facilitate firms' interaction with nonmarket actors such as the host government. This study posits that country-of-origin agglomeration in a host location can help MNEs take collective actions and achieve collective gains in their interactions with the host government, and can thus increase the attractiveness of the location as an investment destination for MNEs from the same home country (i.e., compatriot MNEs).

We start with the premise that when investing abroad, MNEs need to engage the host government as they operate within the confines of the institutional rules established and enforced by the host government (Eden, Lenway, & Schuler, 2005). MNEs interact with the host government to seek a favorable institutional environment or avoid unfavorable treatment (Haveman, Jia, Shi, & Wang, 2017). Extant research has suggested that MNEs' financial, technological, and other resources increase their contribution to the local economy and help engage the host government (Moon & Lado, 2000).

In this study, we advance the idea that country-of-origin agglomeration can facilitate engagement with the host government. We develop this idea by building on insights from the collective action research (Nebus & Rufin, 2010; Olson, 1965; Ostrom, 1990). We suggest that country-of-origin agglomeration enables compatriot MNEs as a group to take collective action in bargaining or relationship building with the host government. Such collective action brings about collective gains for colocated compatriot MNEs that would otherwise be difficult to obtain

if they acted alone; collective gains can be reflected in favorable government treatment and reduced government intervention. While collective action may be challenged by coordination problems such as conflicting goals and free riding (Lee, Struben, & Bingham, 2018; Mesquita & Lazzarini, 2008; Olson, 1965), we maintain that informal institutions that bond compatriot MNEs in a location can increase group cohesiveness and facilitate their joint efforts to interact with the host government.

In line with this argument, we empirically examine whether locations with country-of-origin agglomeration will be particularly attractive to MNEs when they as a group are put in a disadvantaged position vis-à-vis the host government. In such an adverse institutional environment, the need increases for compatriot MNEs to take collective actions to engage the host government, which can be facilitated by country-of-origin agglomeration. To capture an adverse environment, we rely on an exogenous diplomatic shock between the home and host countries that aggravates regulatory burden for MNEs in the host country. Specifically, China and South Korea had a major political dispute in 2016 that put Korean MNEs operating in China in a precarious situation. We expect that in choosing where to locate in China, Korean MNEs will be more attracted to regions with a higher level of country-of-origin agglomeration after the dispute than before the dispute. We also expect this relationship to be more salient for more resource-constrained firms such as smaller Korean MNEs and for regions with weaker institutions. Using various model specifications and measurements, we find robust support for our hypotheses.

This study adds to research on agglomeration and location choice. Prior studies highlight the benefits of country-of-origin agglomeration including resource access and knowledge spillover from interactions with market forces. Beyond such commonly recognized economic benefits, we submit that country-of-origin agglomeration can facilitate collective actions and create collective gains for MNEs in their interactions with the host government. Thus, locations with country-of-origin agglomeration are attractive to MNEs not only because of the benefits associated with engaging various market actors but also because of the nonmarket benefits associated with engaging the host government, including obtaining favorable treatment or navigating an adverse institutional environment in a host country. Our finding that MNEs are more attracted to locations with country-of-origin agglomeration after a diplomatic dispute suggests that MNEs may expect such nonmarket benefits of agglomeration. Our study also advances relevant empirical research (e.g., Chang & Park, 2005; Tan & Meyer, 2011). First, we introduce more fine-grained measures of agglomeration to disentangle the effects of country-of-origin agglomeration and industry agglomeration. Second, we employ a quasi-experiment (i.e., the exogenous political dispute) to examine the nonmarket benefits of country-of-origin agglomeration.

2 | THEORY AND HYPOTHESIS DEVELOPMENT

2.1 | The agglomeration literature

Early research has primarily focused on industry agglomeration—colocation of firms from the same industry, and its impact on MNE location strategy (Chung & Alcacer, 2002; Chung & Song, 2004; Head et al., 1995; Shaver & Flyer, 2000). Industry agglomeration benefits firms because of the positive externalities (Arthur, 1990; Katz & Shapiro, 1985) that emerge from knowledge spillover and resource sharing (Alcácer & Zhao, 2016; Krugman, 1991; Marshall, 1920; Porter, 1998; Zhao, 2006).

Recent studies have examined country-of-origin agglomeration, namely, clustering of firms from the same country in a foreign location (Chang & Park, 2005; Martin, Swaminathan, & Mitchell, 1998; Mesquita, 2016; Stallkamp et al., 2018; Tan & Meyer, 2011; Zaheer et al., 2009). Country-of-origin agglomeration can offer various economic benefits for firms to improve their efficiency in interacting with market forces. First, compatriot firms colocated in a foreign country can provide local market information and knowledge that facilitates entering and settling into the local environment (Tan & Meyer, 2011). Second, these firms can provide crucial resources to one another in a foreign market such as raw materials (Martin et al., 1998), financial capital (Kalnins & Chung, 2006), and employees who are familiar with their home language, culture, management styles, and operating routines (Chang & Park, 2005; Cuervo-Cazurra, Maloney, & Manrakhan, 2007). Third, the shared language and cultural values from co-ethnicity facilitate trust and cooperation among employees, suppliers, customers, and other stakeholders in the market, and reduce transaction costs in economic activities (Li, Hernandez, & Gwon, 2019).

The agglomeration literature has also explored the role of nonmarket forces. It is mainly concerned with legal devices such as noncompete clauses that can be used to deal with knowledge (mis)appropriation within a cluster, and the impact of such legal devices on the development of a cluster (Gilson, 1999; Marx, Singh, & Fleming, 2015). This literature has yet to examine the role of agglomeration in helping firms engage a key nonmarket actor, the government. Our study adds to this line of research by highlighting that country-of-origin agglomeration can offer collective benefits to MNEs in their interactions with the host government.

2.2 | Country-of-origin agglomeration and collective gains in MNE–government interactions

When an MNE enters a foreign location, it must engage the host government to secure a favorable regulatory environment or avoid an unfavorable one (Moon & Lado, 2000; Müllner & Puck, 2018). Such engagement is necessary because the government, including the political and judicial bodies, is responsible for delineating and enforcing the formal rules and regulations that directly affect the operations of MNEs (North, 1990). MNEs can engage the host government either formally through negotiating and bargaining or informally through relationship building and accumulation of goodwill. Studies focusing on bargaining have shown that MNEs with greater bargaining power can negotiate better deals with the host government (e.g., higher subsidiary ownership level in case of foreign ownership restrictions) and minimize incidents of government intervention (Fagre & Wells, 1982; Lecraw, 1984; Poynter, 1982). Sources of bargaining power include firms' resources (managerial, technological, and reputational) that increase their ability to satisfy host government objectives such as local economic development and export growth (Moon & Lado, 2000). Studies focusing on MNEs' nonmarket strategies suggest that MNEs can accumulate goodwill with local communities and governments and build a reciprocal relationship with the government, which helps firms access government-controlled resources and shield firms from institutional hazards (Sun, Doh, Rajwani, & Siegel, 2021).

In this study, we propose that country-of-origin agglomeration facilitates collective actions and creates collective gains that would be difficult to obtain if MNEs acted alone to engage the host government. First, compatriot MNEs, when colocated, can better establish their contributions to the local economy in terms of tax payment, employment, technology transfer, local industry development, and export revenues (Nebus & Rufin, 2010). Such contributions are

usually considered critical because they help a local government fulfill its objectives to increase government revenue, job creation, foreign technology transfer to local environment, and trade surplus (Head, 2007). Second, compatriot MNEs can build collective goodwill from such tangible economic contributions as well as from participating in corporate social responsibility activities in the host location. Research shows that goodwill or sociopolitical reputation of individual firms can provide political access and protect them from political risks (Darendeli & Hill, 2016; Werner, 2015). It stands to reason that collective goodwill can further facilitate compatriot MNEs' bargaining and relationship building with the host government. Finally, compatriot MNEs can collectively threaten, explicitly or implicitly, to relocate from the host location to other locations in the host country or even to other countries. Such a threat to exit is credible for at least two reasons. One, collective relocation is possible as locations within a host market or between countries often compete with one another to attract a cluster of foreign firms by providing favorable government incentives and policies (Lu, Song, & Shan, 2018; Wang, Zhu, Chen, & Luo, 2021; Zhou, Delios, & Yang, 2002). Two, collective exit is actionable. For example, Korean cellphone manufacturers and suppliers exited Guangdong Province of China en masse, and such an exit had a devastating effect on local economic development (South China Morning Post, 2019). Collective threat to exit lends more bargaining power to firms than exit threat from individual firms because collective relocation would result in more job losses and greater tax income reduction; as a result, the host government would be more sensitive to such collective actions (Patnaik, 2019). In conclusion, compatriot MNEs, when colocated, can leverage collective resources (such as collective contributions, goodwill, and threat to exit) to take collective actions in bargaining or building relationship with the host government.

The resulting collective gains from collective action of compatriot MNEs manifest themselves in the following two aspects. First, the host government may offer favorable policy and resource support (e.g., permission to operate in local markets, tax rebates, low-rent land, and subsidies) to attract and retain the conational group in the location. Second, the host government may hesitate to impose adverse policies on individual firms in this group for fear of negative consequences including collective exits. In this sense, compatriot MNEs colocated in a host region become stronger when they work together; they can gain greater access to valuable government-controlled resources as well as better buffer themselves from adverse institutional changes.

The collective gains, however, will only materialize if the colocated compatriot MNEs have the incentive and capacity to act as a cohesive group when interacting with the host government. Problems such as conflicting goals, free riding, and opportunism may jeopardize collaboration among these MNEs (Lee et al., 2018; Olson, 1965). Specifically, firms may refrain from pooling together their resources if they have different goals or issue preferences (Nebus & Rufin, 2010). Free riding and opportunistic behavior of some members can also thwart other members' incentive to participate in collective actions (Olson, 1965). These problems tend to be severe when coordination is required among a large number of firms or between direct rivals (Patnaik, 2019). In particular, collaborating with direct rivals from the same home country may expose an MNE's propriety knowledge and resources to competitors and harm its competitive advantage (e.g., Alcácer & Zhao, 2012).

We submit that these collaboration problems can be contained or alleviated by the institutions that bond compatriot MNEs in a foreign location. Institutions are constraints devised to shape exchange, and as such, can help align member interests, monitor member behavior, and deter opportunism (North, 1990). Although interdependencies among actors create potential for joint value creation, this value is hard to realize in the absence of strong institutions

(Olson, 1965). Both formal and informal institutions set the rules of the game; unlike formal institutions that are inscribed in laws and regulations, informal institutions are “embodied in customs, traditions and codes of conduct” (North, 1990, p. 6). In our context, co-ethnicity and country-of-origin business associations function like informal institutions that incentivize and enable colocated compatriot MNEs to join efforts when engaging the host government.

Co-ethnicity, especially in a foreign setting, embodies the norms and values shared by compatriot MNEs (Cuypers, Ertug, Cantwell, Zaheer, & Kilduff, 2020; Li et al., 2019), and it is a powerful source of identity and solidarity that transcends national borders (Hernandez, 2014; Hernandez & Kulchina, 2020; Iriyama, Li, & Madhavan, 2010). The shared values and norms in the same ethnic group prescribe behavior, enforce sanctions, and build trust among the members (Coleman, 1988; Greif, 1989, 1993; Zhang, 2020). Greif (1989), for example, shows that Mediterranean traders use informal institutions based on ethnic coalitions to motivate traders to adhere to (rather than deviate from) the implicit contracts among them. Co-ethnicity can facilitate collaborations even among direct rivals. Tan and Meyer (2011) suggest that shared cultural backgrounds and languages in a co-ethnic group ease the intensity of competition and reduce knowledge appropriation hazards. Kalnins and Chung (2006) also show that with a sense of shared destiny and shared values, established members with more resources in a co-ethnic community are likely to help the less resourceful members to survive in a host country, even when they are direct competitors and when the possibility of future reciprocation is remote. In this regard, co-ethnicity works like a social glue that increases group cohesiveness and facilitates compatriot MNEs' collective actions in a foreign location.

The institutional effect of co-ethnicity is further reinforced by country-based business associations that often locate in places with concentrated MNEs of the same country of origin. Country-based business associations provide a formalized mechanism to pool and manage resources from individual members (thus alleviating the free riding problem) and pursue the common goals of the members (thus aligning the goals of different members) (Grier, Munger, & Roberts, 1994). They rely on shared values and norms and in some cases stipulate written rules to govern the behavior of individual and organizational members (Li et al., 2019). For these reasons, country-based business associations can further increase the cohesiveness of co-ethnic groups and enable their collective actions.

Country-based business associations also represent a concrete channel through which compatriot MNEs can form and deliver a collective voice when engaging the host government. Research shows that business or trade associations represent a main channel for companies including MNEs to conduct collective political activities (Bucheli, Salvaj, & Kim, 2019; Hillman & Hitt, 1999; Jia, 2014; Schnyder & Sallai, 2020). These associations serve as umbrella organizations to represent the common interests of their member companies, engaging in communications, consultations, and lobbying activities (Deng & Kennedy, 2010; Hansen, Mitchell, & Drope, 2004). For example, country-based business associations may convey challenges facing businesses from the same home country and provide policy recommendations to government agencies as well as engage in public relations and trust building activities with government officials (Kennedy, 2007).

In sum, through country-of-origin agglomeration, compatriot MNEs can leverage their collective resources to take collective action and achieve collective gains when engaging the host government. Collaboration problems can be mitigated by informal institutions that come with country-of-origin agglomeration including co-ethnicity and country-based business associations.

2.3 | Research context: Agglomeration of Korean MNEs in China

Before introducing our hypotheses, we discuss the research context and draw on qualitative evidence from news reports, organizational websites, and personal interviews to verify the theoretical mechanisms elaborated above.¹ South Korea was among the six largest foreign investors in China for our sample period (Ministry of Commerce of China, 2018). Korean investments in China are concentrated in clusters, with Shandong, Shanghai, Jiangsu, Guangdong, and Shaanxi as the top five locations for new Korean establishments in recent years (2013–2018, see Table A2 in the Appendix).

Our interviews suggest that agglomeration of Korean MNEs indeed facilitates collective action and enhance engagement with the host government in China. When asked whether Korean firms feel stronger in engaging the Chinese government if they are located together, a professor in a Korean business school (interview #1) notes, “Korean firms’ size and industry vary, so their individual bargaining power may not be that large. But together, they form a potent group of interest and engage local government proactively.” Similarly, an executive in a large Korean conglomerate (interviewee #2) suggests that “geographic collocation of Korean firms provides advantages for negotiations with the Chinese local government since we can form a common voice in responding to the local government.” Regarding collective threats to exit, a professor in a Korean university (interviewee #6) notes that “Korean MNEs’ collective threats to exit are credible but are typically implicit to avoid giving the host government a bad impression.”

We further verify the idea that agglomeration creates collective gains for Korean firms from the perspective of the Chinese government. According to a local Chinese government official (interviewee #3), the government values agglomeration of Korean MNEs, and is willing to provide favorable policies such as tax rebates and reduced land rents to a group of Korean MNEs located in a region. A professor in a Korean university (interviewee #4) notes that the city of Xi’an in Shaanxi Province set up a task force to focus specifically on attracting a group of Korean MNEs in semiconductor-related businesses. This observation is further corroborated by our interview with a senior manager (interviewee #5) in one of the Korean semiconductor companies located in Xi’an. All three interviews indicate that host governments value clusters of Korean MNEs in China.

We also learned that both co-ethnicity and Korean business associations provide important institutional mechanisms to discipline member behavior. Co-ethnicity, and the shared values, culture, language, and even management styles, enable collaborations and minimize opportunistic behavior of Korean MNEs in China. For example, in the Association of Koreans in Shenyang, members are expected to follow certain norms of conduct—many of them tacit—and are punished (e.g., warned or expelled from the group) if they break the community’s trust (Li et al., 2019). Similarly, our interviews with two executives in Korean MNEs (interviewees #9

¹We conducted 10 interviews from June 2019 to January 2022 in China and South Korea. The interviewees include four executives in Korean MNEs that have operations in China, one manager and one established researcher in two prominent Korean business associations that have operations in China, three professors in South Korean universities that have research expertise and consulting experience with Korean firms doing business in China, and one Chinese government official working in one of the Korean clusters in China (i.e., Guangdong Province). The four executives in Korean MNEs are interviewee #2 (President of the Shanghai branch of a Korean conglomerate), interviewee #5 (a former manager responsible for government affairs in China for a large Korean conglomerate), interviewee #9 (CEO of a major supplier for a large Korean conglomerate), and interviewee #10 (managing director of the planning department in a major supplier for a large Korean conglomerate).

and #10) suggest that Korean companies are expected to comply with the norms and codes of conduct of the business associations they join. In case of violations, they will be punished and may even be excluded from the associations.

Our qualitative evidence suggests that Korean business associations in China facilitate collective actions of Korean MNEs in engaging the host government. When asked how Korean firms collaborate with other Korean peers in the same location to engage the local Chinese government, the interviewees, including company executives, scholars in Korean universities, and staff in Korean business associations, pointed to the central role of Korean business associations.² For example, interviewee #1 remarks, “I have seen local Korea Chamber of Commerce and Industry formed by prominent Korean businesspersons. Through the Chamber, Korean businesspersons interact with one another, exchange information, and when necessary, take actions together to obtain favorable regulatory outcomes for them.” Both interviewee #7 and interviewee #8 indicate that the local offices of their business associations support colocated Korean MNEs to engage national and subnational governments in China. The two interviewees also suggest that their associations are private organizations with voluntary memberships, which is consistent with our idea that business associations function largely as informal institutional mechanisms that bond Korean MNEs.

2.4 | Country-of-origin agglomeration, regulatory burden, and location choice

We have so far suggested that country-of-origin agglomeration can enable collective actions and bring in collective gains for MNEs in their interactions with the host government. It follows that such locations with country-of-origin agglomeration should be attractive to MNEs. Detecting a positive effect of country-of-origin agglomeration on an MNE's location choice, however, is insufficient to tease out the nonmarket benefits of country-of-origin agglomeration. This is because literature has established that locations with country-of-origin agglomeration are attractive to entry because of other benefits derived from an MNE's interactions with important market forces (Chang & Park, 2005; Zaheer et al., 2009).

In this study, we resort to a moderating variable approach to test our key ideas (e.g., Haans, Pieters, & He, 2016; Hernandez & Shaver, 2019; Hoetker, 2007; Li, Meyer, Zhang, & Ding, 2018; Li, Xia, & Zajac, 2018; Wang, He, & Mahoney, 2009; Zelner, 2009). We suggest that the benefits of country-of-origin agglomeration will be greater when compatriot MNEs encounter higher burden that affects them as a group and is tied closely to the actions of the host government (and not so much to the actions of the market forces). In the presence of significant regulatory burden, compatriot MNEs will have a greater need for country-of-origin agglomeration and the collective actions it enables to engage the host government and reduce regulatory burden. Even when compatriot MNEs are direct competitors, they will likely have a greater sense of shared destiny under a common environmental threat and may thus have stronger motivation to take collective actions and less incentive to deviate. Our overall proposition for empirical analysis

²According to an expert scholar working in Korean International Trade Association (KITA) (interviewee #7), at least nine Korean business associations are in place to facilitate trade and investment between China and South Korea; the more prominent ones include Korea Chamber of Commerce and Industry (KCCI), KITA, and the KOTRA. The websites of these associations show clearly that they are established to protect the rights and interests of Korean companies and that they engage the Chinese government for this purpose. These associations often have branch offices in Chinese regions that have clusters of Korean MNEs.

therefore is that locations with greater country-of-origin agglomeration will be more attractive to MNEs when they face higher regulatory burden in the host market.

To capture regulatory burden that MNEs face in a host country, we resort to an exogenous diplomatic shock between MNEs' home and host countries that intensifies diplomatic tensions and increases regulatory burden for MNEs in the host country. Diplomatic relations between MNEs' home and host countries often affect the institutional environment that MNEs face in the host country (Duanmu, 2014; Elliott & Hufbauer, 1999; Li, Meyer, et al., 2018; Li, Xia, & Zajac, 2018). As governments sometimes use economic sanctions to deal with political disagreements, MNEs from the home country that has tensions with the host country may become targets of retaliation and face negative policy ramifications in the host country (Duanmu, 2014; Li & Vashchilko, 2010; Marquis & Raynard, 2015). This is particularly likely in an emerging market where policy makers are less constrained by formal institutions and have more autonomy to act unilaterally to introduce new policies in response to exogenous shocks (Haveman et al., 2017; Henisz & Macher, 2004). For example, the host government may impose regulatory burdens on targeted MNEs such as increase in taxes and fees, delay in obtaining permits and registering businesses, and limited access to certain resources and customers, all of which threaten the performance of MNEs (Henisz & Zelner, 2001; Jia, 2014; Medina, Bucheli, & Kim, 2019).

In our context, the Terminal High Altitude Area Defense (THAAD) dispute between China and South Korea epitomizes such diplomatic tensions that heighten the regulatory burden for Korean firms in China and weaken their position to interact with the host government in China. The dispute started in July 2016 when the United States and South Korea agreed to the deployment of the THAAD system in South Korea. The agreement raised immediate, strong opposition from the Chinese government that viewed THAAD as a national security threat (Financial Times, 2016). The Chinese government swiftly initiated unfavorable policy changes, targeting specifically Korean firms (Wall Street Journal, 2017a). For example, news reports indicate that after the dispute, some Korean firms (e.g., Lotte Mart) and industries (e.g., car manufacturing and entertainment) experienced delays at the customs, suspension of business operations, and changes or cancellation of investment plans and subsidies by the Chinese government (Financial Times, 2017; Lim, 2019). By contrast, little evidence suggests that firms from other countries experienced similar regulatory burdens in China as a result of the THAAD dispute.³ Thus, the dispute's negative impact on the institutional environment is confined largely to Korean MNEs in China.

Moreover, the THAAD dispute has a long-lasting effect in terms of worsening the institutional environment for Korean MNEs in China and thus affects decisions with long-term consequences such as Korean MNEs' subnational location choice in China. When the THAAD dispute started, there were no signs of an immediate diplomatic solution to the dispute. The two countries agreed to set aside the dispute in October 2017, 15 months after the dispute (Wall Street Journal, 2017b). Even with such an agreement, however, news reports indicate that the two countries were still in discussion of repairing their diplomatic relations during 2019–2021, three to 5 years after the dispute (South China Morning Post, 2021). Surveys of Korean MNEs in China also suggest that even in 2019 some Korean firms still felt the pain caused by the THAAD dispute and found it difficult to operate due to investigations by the host government

³We searched extensively news reports for 2016–2019 from three sources (Access World News, Google, and Naver) and found no evidence that the THAAD dispute affects non-Korean foreign firms in China. Access World News is one of the world's largest full-text news databases and Naver is a South Korean online search engine.

(Korea International Trade Association, 2019). Thus, the prolonged effect of the THAAD dispute creates a new reality that Korean MNEs have to face in their location decisions in China.

Since the THAAD dispute represents an exogenous event that increases regulatory burden for Korean firms operating in China, we expect that Korean firms are in greater need for taking collective actions to mitigate the heightened burden after the THAAD dispute than before the dispute. It follows that Korean MNEs will be more attracted to locations in China with a higher level of country-of-origin agglomeration after the THAAD dispute. Our interviews also suggest that Korean MNEs attach great importance to agglomeration after the THAAD dispute as they believe that clustering with other Korean firms can help them engage the Chinese government.⁴ Formally, we reach the following hypothesis.

Hypothesis 1 (H1). *Country-of-origin agglomeration in a host location will have a more positive effect on the likelihood of an MNE's choice of that location for new establishments after a diplomatic dispute between the MNE's home and host countries (e.g., since the THAAD dispute in 2016) than before the diplomatic dispute (e.g., before 2016).*

We posited that regulatory burden in a host location increases MNEs' need for country-of-origin agglomeration and the collective actions it facilitates. This need varies among individual MNEs given the heterogeneity in resource endowments. Resource-rich MNEs may have contributed more to local economic development, accumulated more goodwill with the government, and had more bargaining power than other compatriot MNEs. Even if resource-rich MNEs cannot strike better deals in case of a sweeping policy change that targets the compatriot group as a whole, they may have the resources to survive the initial impact until the situation turns better. For these reasons, MNEs with stronger resource endowments may have less incentive or need to take collective actions to address regulatory burden.

Empirically, absent a precise measure of resource endowment, we focus on the size of MNEs. Specifically, large firms may muster more financial, technological, and reputational resources, all of which contribute to their bargaining power and relationship building with the government (Alcácer & Chung, 2014; Shaver & Flyer, 2000). For example, large firms are shown to be more likely to gain leverage over the host government in their negotiations on the equity ownership level for their subsidiaries (Lecraw, 1984). In addition, large firms typically have their own public or government affairs offices to engage nonmarket actors, which further demonstrate their resource advantages (Boddewyn, 2007; Deng & Kennedy, 2010). As large firms can leverage their own resources to bargain or build relationships with the host government, they may depend less on country-of-origin agglomeration and the collective actions to survive the impact of adverse policies.

In contrast, small firms are more resource-constrained in engaging the host government. They usually lack the resources, bargaining power, and goodwill that large firms enjoy, and consequently have a greater need for collective actions to deal with regulatory burden and other adversities (Mesquita & Lazzarini, 2008). Not surprisingly, research suggests that firms with more resource constraints are more inclined to join a coalition of firms to engage the

⁴For example, interviewee #9 (CEO of a Korean MNE) remarks, "after the THAAD dispute, I think it is essential to consider the 'stronger together' effect by clustering with other Korean firms. I expect bargaining power will be increasing in relation to the Chinese government since economic contributions of a cluster of Korean firms are much more powerful." Similarly, interviewee #10 (executive in a Korean MNE) suggests that co-locating with other Korean firms is "essential for increasing bargaining power and reducing risks from the Chinese government after the THAAD dispute."

government (Hillman & Hitt, 1999). In the presence of the diplomatic dispute and heightened regulatory burden, firms with more resource constraints such as small firms will likely depend more on country-of-origin agglomeration and will be more attracted to locations with agglomeration of compatriot MNEs.⁵ Hence:

Hypothesis 2 (H2). *The positive effect of country-of-origin agglomeration in a location on the likelihood of an MNE's choice of that location after a diplomatic dispute, as specified in H1, will be more salient for small than large MNEs.*

The above discussion has not addressed the fact that the institutional quality varies at the subnational level in a large host market such as China (Chan, Makino, & Isobe, 2010; Shi, Sun, & Peng, 2012). Decentralization of power from central to local government in China means that local governments have broad authority in allocating resources and developing policies that affect businesses (Lin & Liu, 2000). However, subnational institutional quality varies significantly. Some regions have higher institutional quality as they allow the market principles to dominate, limit government interference in the market, respect the rule of law, and protect property rights. By contrast, some regional governments have less respect for the rule of law and property rights; they may impose undue regulatory burdens on firms to increase revenues for government or individual use (Witt & Redding, 2013). Such heterogeneity is attributed to differences across regions in economic, cultural, institutional, and historical conditions (Meyer & Nguyen, 2005; Yan & Chang, 2018).

The implication of subnational variation in institutional quality is that regulatory burden on Korean MNEs as a result of the THAAD dispute may not be evenly distributed across different subnational locations in China. In locations with weaker institutional rules, local governments may be more inclined to take advantage of the THAAD dispute and impose regulatory burdens on Korean MNEs, which puts Korean MNEs in a particularly vulnerable position in dealing with the host government. Thus, when entering a subnational location with weaker (versus stronger) institutions after the THAAD dispute, Korean MNEs have an even greater need for country-of-origin agglomeration. In other words, country-of-origin agglomeration will have a more beneficial effect on an MNE's location choice when the location it considers entering has lower institutional quality. We thus propose:

Hypothesis 3 (H3). *The positive effect of country-of-origin agglomeration in a location on the likelihood of an MNE's choice of that location after a diplomatic dispute, as specified in H1, will be more salient when that location has weaker (as opposed to stronger) institutions.*

3 | METHODS

3.1 | Data and sample

We test our hypotheses using a sample of South Korean firms that have located new establishments in different regions in China (i.e., provinces, provincial-level municipalities, and

⁵Interviewee #9 notes, "Small and medium-sized companies generally have less bargaining power (technology, capital, reputation, etc.) compared to large companies, such as Samsung, LG, and Hyundai Motor. So the 'stronger together' effect is more important for us after the THAAD dispute."

autonomous regions). We construct our samples based on two firm-level datasets. Data on location choice of new Korean establishments and Korean-firm agglomeration come from the Overseas Activities Directories of Korean Firms published by the Korea Trade Investment Promotion Agency (KOTRA), which includes information on new establishments (e.g., year of establishment, location, industry) of Korean firms in China during 1967–2018. To ensure that the institutional environments in the sample remain otherwise as stable as possible, we focus our analysis on the location choices between 3 years before the THAAD dispute (2013–2015) and 3 years since the THAAD dispute (2016–2018). A small-scale conflict occurred in 2011 when a South Korean coast-guard officer was stabbed while trying to seize a Chinese fishing boat in the Yellow Sea. We assume that the ramifications of this event would have faded by 2013. To our knowledge, there is no other major political shock or regulatory change targeting specifically Korean firms in China during this time period that may confound the effect of the THAAD dispute.

The second data source is the Annual Survey of Industrial Firms (ASIF) in China, which we use for calculating the agglomeration measures of non-Korean firms for each industry in each region each year. We compare Korean and non-Korea firms in both same/related and unrelated industries to tease out the effects of country-of-origin agglomeration and industry agglomeration, as we discuss below. The ASIF data, collected by the National Bureau of Statistics of China, include all firms in the industrial sectors in China with annual sales of at least 5 million Yuan and provide information on firms' location, industry, and ownership (foreign or Chinese). As data are only available to us till 2008, we use the 2008 value as the proxy to create the agglomeration measures for non-Korean firms from 2013 to 2018. For robustness test, we create two sets of alternative measures for non-Korean firms using linear extrapolation of data from the most recent years (2007 and 2008) and data from all available years (1998–2008).

We derive our final sample by merging the KOTRA and ASIF data. The sample consists of 138 new Korean establishments in 11 industrial sectors located in 17 different regions in China during 2013–2018. Tables A1 and A2 in the Appendix present the industry and regional distributions of our sample.

3.2 | Model specification

We compare how country-of-origin agglomeration in a location influences the likelihood of a Korean MNE's choice of that location for a new establishment before and after the THAAD dispute. Following extant research, we estimate conditional logit models for location choice (e.g., Alcácer & Chung, 2007; Belderbos, Van Olffen, & Zou, 2011; Li et al., 2019; Tan & Meyer, 2011). In this model, each firm is faced with a set of alternatives to choose from when building a new establishment in China, which in this analysis is a set of regions (31 in total) with different attributes.⁶ For firm i in industry s establishing a subsidiary in region j in year t , we estimate the following equation:

⁶For a given year, most firms had only one new establishment in a region. If the same firm had multiple establishments in *different* regions in *different* years, we code them as separate observations. If a firm had multiple establishments in the *same* region in the *same* year, we only consider one of them. It does not matter which one we consider, as the variations in our independent variables are at the industry-province-year level. Our sample of new establishments in 2013–2018 does not have cases where a firm had multiple establishments in *different* regions in the *same* year. Therefore, there is no serious concern of cross-sectional dependence in error terms across different observations in our regression analysis.

$$\Pr\left(Y_{isjt}=1|X_{sjt-1}, W_{sjt-1}, \sum_{j=1}^J Y_{isjt}=1\right) = \frac{\Pr\left(Y_{isjt}=1, \sum_{l \neq j} Y_{isl}=0|X_{sjt-1}, W_{sjt-1}\right)}{\Pr\left(\sum_{j=1}^J Y_{isjt}=1|X_{sjt-1}, W_{sjt-1}\right)} \\ = \frac{\exp\left(\beta_1 X_{sjt-1} + \beta_2 W_{sjt-1}\right)}{\sum_{j=1}^J \exp\left(\beta_1 X_{sjt-1} + \beta_2 W_{sjt-1}\right)}$$

where $\Pr(Y_{isjt}=1)$ is the probability that in year t a Korean firm i in industry s chooses to locate in region j instead of other alternative locations. X_{sjt-1} is a set of region characteristics such as agglomeration, all industry- and region- and time-varying. W_{sjt-1} includes the interaction terms between agglomeration and a dummy variable indicating the post-THAAD period, as well as the control variables. We take a one-year lag of all explanatory and control variables in this study unless otherwise specified to minimize potential reverse causality concerns. The sample observations are at the firm-region-year level. The conditional logit model considers location traits with time-invariant firm fixed effects (Alcácer & Chung, 2014; Greene, 2012); any time-invariant firm traits such as industry type and business group affiliation are controlled for (Train, 2003). For this reason, we also exclude the dummy variable indicating the post-THAAD period (measured as a dummy that indicates whether a Korean firm was established before or after the THAAD dispute) to avoid perfect collinearity.

3.3 | Variables and measurements

3.3.1 | Dependent variable

For location choice, we use a dummy variable at the firm level, which is coded as one if a Korean firm i in industry s established a subsidiary in region j in year t , and zero otherwise (Alcácer & Chung, 2007; Chang & Park, 2005; Li et al., 2019). Data come from KOTRA.

3.3.2 | Explanatory variables

Building on extant research (Tan & Meyer, 2011), we introduce four agglomeration measures to disentangle the effects of country-of-origin agglomeration and industry agglomeration. For a focal firm in each industry in each region each year, there are four possible categories of agglomeration that are mutually exclusive: (a) *Korean-firm agglomeration in same and related industries*, (b) *Korean-firm agglomeration in unrelated industries*, (c) *non-Korean-firm agglomeration in same and related industries*, and (d) *non-Korean-firm agglomeration in unrelated industries*. Industry agglomeration refers to colocation of firms in the same and related industries. Without a distinction between same/related and unrelated industries, we may not be able to tease out the effect of country-of-origin agglomeration from that of industry agglomeration. In other words, if we combine (a) and (b) into one measure of Korean-firm agglomeration, a positive effect of the measure may reflect the joint effect of country-of-origin agglomeration and industry agglomeration, as pointed out by Tan and Meyer (2011). Our four-category classification has two advantages. First, our classification allows us to compare (a) and (c); any difference between the effects of the two measures will more clearly indicate the effect of country-of-origin

agglomeration because the effect of industry agglomeration is controlled for. Second, category (b) Korean-firm agglomeration in unrelated industries can capture the country-of-origin agglomeration effect unambiguously (Tan & Meyer, 2011). We can further compare (b) and (d); any difference between the effects of the two measures will reflect the effect of country-of-origin agglomeration after the effect of unrelated industries is controlled for. For robustness test, we also create agglomeration measures without differentiating between same/related and unrelated industries (see Table A7 in the Appendix).

Agglomeration is measured as the cumulative count of establishments of corresponding firms in each region each year. For example, category (a) is measured as the cumulative number of Korean establishments in the same and related industries of a focal firm (we define “related” industries below). Non-Korean firms refer to non-Korean foreign firms. We exclude Chinese firms from non-Korean firms because Chinese firms are not subject to the liability of foreignness and may have deep local connections and behave differently from foreign firms in location choice. As such, inclusion of Chinese firms in the non-Korean firm category may not serve as a good benchmark to compare the effects of Korean and non-Korean agglomeration on Korean MNEs’ location choice. In robustness tests, we include Chinese firms in the measure of non-Korean firm agglomeration and obtain similar results (see Table A8b in the Appendix).

We measure agglomeration of same/related industries as follows (e.g., Li, Xia, & Zajac, 2018). First, we calculate a focal industry’s input and output ratios by using the input–output data collected from the National Bureau of Statistics of China. We obtain input ratios by dividing a focal industry’s input from each of the upstream industries by the total input that goes to the focal industry; we obtain output ratios by dividing a focal industry’s output to each of the downstream industries by the focal industry’s total output. Input–output data are available until 2015. We use the ratios based on the 2015 I–O data for 2013–2018. Second, we use the average of the input and output ratios to measure *relatedness* between two industries because the two ratios are highly correlated. We define an industry as *related (unrelated)* to a focal industry if its relatedness to the focal industry is above (below) the median value of relatedness. Third, we calculate agglomeration of related industries as the summation of the number of establishments in all related industries weighted by their corresponding measures of relatedness to the focal industry. We use relatedness as the weight because industries with a larger percentage of their input or output into the industry where a focal firm belongs are expected to generate stronger externalities for the focal firm and have a larger impact on its location choice. This type of weighted measure has been used in previous research to capture spillover effects across industries (e.g., Javorcik, 2004; Li, Meyer, et al., 2018; Li, Xia, & Zajac, 2018). Finally, *Korean-firm agglomeration in same and related industries* is the summation of two parts: Korean-firm agglomeration in the same industry (i.e., the number of Korean establishments in the focal industry), and Korean-firm agglomeration in related industries. We use the same procedure to generate the measure of *non-Korean-firm agglomeration in same and related industries*.

Korean-firm agglomeration in unrelated industries is calculated as the summation of the number of Korean establishments in all unrelated industries. The number is not weighted because conceptually relatedness is not relevant to unrelated industries. *Non-Korean-firm agglomeration in unrelated industries* is calculated similarly. These four measures of agglomeration are standardized in regression analyses to facilitate comparison of their effects.

We create a dummy to examine the impact of agglomeration on location choice before and since the THAAD dispute. *Post-THAAD* dummy takes the value of one if an observation is in

the post-THAAD period of 2016–2018 and zero if the observation is in the pre-THAAD period of 2013–2015.

We collect data on the size of Korean parent firms from the Korea Investors Service (KIS) database. KIS is the equivalent of Standard and Poor's in the United States and provides information on corporate profiles and financial performance of all listed Korean companies since 1980 (Chang & Hong, 2002; Chang & Rhee, 2011). For each Korean establishment in China reported in KOTRA, we first manually identify the name of the corresponding Korean parent using Qi Cha Cha (one of China's top corporate information systems) and then gather the Korean parent's information from KIS. We create a dummy, *large firm*, which equals one if the parent firm is among the top 200 in KIS in terms of market capitalization value and zero otherwise. For robustness checks, we generate alternative measures of large firms based on assets and sales and obtain similar results (see Table A9 in the Appendix).

We measure subnational institutional quality using the “government and market relations” subindex in the Marketization Index for China's Provinces developed by the National Economic Research Institute (NERI).⁷ This subindex has three dimensions: (a) the extent to which employment is decreased among government agencies, measured by the number of government employees as a share of the total population, (b) the extent to which the government limits its interference in firms, measured by the proportion of working time spent by entrepreneurs in dealing with government agencies and officials, and (c) the extent to which the market dominates the allocation of economic resources, measured by the government budgetary expenses as a proportion of gross domestic product (for detailed explanations, see Wang et al., 2017). We calculate the average score for the three dimensions for each region each year. We then reversely code each score by multiplying it with -1 to facilitate interpretation: A higher score indicates weaker institutions, and we name the new variable *subnational institutional weakness*.

3.3.3 | Control variables

Regional factors (economic, infrastructural, cultural) may attract new MNE investment and drive country-of-origin agglomeration (Alcácer & Chung, 2014). We include four variables to account for local economic conditions. First, *labor resource* (an important input for Korean firms) is measured as the proportion of rural labor among all workers in each region each year. The measure is from NERI and a higher score likely indicates greater accessibility to the labor pool and lower labor cost (Wang et al., 2017). Second, *GDP per capita*, calculated as the logarithm of regional GDP per capita, captures the robustness of the regional economy, which may attract foreign subsidiaries. Third, firms may be attracted to special economic zones that have greater economic opportunities, better economic infrastructure, and more favorable policies toward FDI. *Special economic zone* is the number of National High-Tech Industrial Development Zones in a region. Data come from China's Ministry of Science and Technology (<http://www.most.gov.cn/zxgz/gxjscopykfq/index.html>). Fourth, *top industry*, a dummy variable, indicates whether a Korean establishment belongs to the industry with the highest gross output among all the industries in each region each year. The top industry in a region will likely

⁷The Marketization index has five subindices: government and market relations, development of the nonstate enterprise sector, development of the commodity market, development of factor markets as well as market intermediaries and the legal environment for the market (Wang, Fan, & Yu, 2017).

receive government support, which makes it more attractive to new establishments in that region (Belderbos et al., 2011; Delios & Henisz, 2003). Data come from ASIF.

To capture a region's infrastructure quality, we use *highway per area*, measured as the length of the highways in a region in kilometer divided by the size of the region in square kilometer (Chang & Park, 2005). Better infrastructure allows more effective transfer of goods and services and may thus attract more foreign investment (Ghani, Goswami, & Kerr, 2016). Data on GDP and infrastructure come from the China Statistical Yearbook. We use *cultural tightness*, developed by Chua, Huang, and Jin (2019), to control for a region's cultural attributes. This variable captures the degree to which a region is governed by rules and norms. Foreign firms may be more attracted to regions with a higher level of cultural tightness because rules and norms in these regions are better enforced. We further control for *geographic distance*, measured as the natural log of the distance in miles between Seoul and the capital city of the region in China that a Korean firm was located (Li, Vertinsky, & Li, 2014; Sorenson & Stuart, 2001). Geographic distance may discourage trade, economic integration, and FDI (Li, Zhang, & Shi, 2020). Information on distance is downloaded from <http://dateandtime.info/distance.php?id1=1815577&id2=1835848>.

Since conditional logit models by default capture time-invariant firm fixed effects, we do not include time-invariant firm-level characteristics such as business group affiliation. In addition, we have considered a broader set of variables to account for locational variations including average years of education among the population, worker's wage, number of patents, number of high-tech firms, and number of state-owned firms. They are highly correlated with other control variables and do not alter the results when included. We thus exclude them in the regression analysis.

4 | RESULTS

Table 1 reports the descriptive statistics and correlation matrix for the variables used in the main regressions. The values of variance inflation factor are all below 4 indicating that multicollinearity is not likely a major concern.

Table 2 reports the conditional logit estimation results for firms' location choice. We start with testing the baseline expectation (not stated as a hypothesis) that there is a positive relationship between country-of-origin agglomeration and the likelihood of a firm's choice of that location for new establishments. In Model 2 of Table 2, the coefficient estimate of *Korean-firm agglomeration in same and related industries* is positive and statistically significant ($b = .220$, $p = .003$), and Wald test suggests that it is significantly larger than the coefficient estimate of *non-Korean-firm agglomeration in same and related industries* ($\chi^2 = 12.44$, $p < .01$). Thus, when the effect of industry agglomeration is controlled for, we still find strong evidence for the positive effect of country-of-origin agglomeration in same and related industries on MNEs' location choice. Further, *Korean-firm agglomeration in unrelated industries* is positive and statistically significant ($b = .299$, $p < .001$), and Wald test shows that it is also significantly larger than *non-Korean-firm agglomeration in unrelated industries* ($\chi^2 = 5.78$, $p = .02$). Thus, country-of-origin agglomeration in unrelated industries also has a significant positive effect on MNEs' location choice. The results taken together suggest that Korean MNEs are more attracted to Korean-MNE agglomeration than non-Korean-MNE agglomeration. In terms of the magnitude, 1 SD increase in *Korean-firm agglomeration in same and related industries* in a location increases the

TABLE 1 Descriptive statistics and correlation matrix: 2013–2018

Variables	1	2	3	4	5	6	7	8	9	10	11	12	13	14
1 Agglo: Korean, same and related industries	1													
2 Agglo: Korean, unrelated industries	0.52	1												
3 Agglo: Non-Korean, same and related industries	0.35	0.12	1											
4 Agglo: Non-Korean, unrelated industries	0.25	0.39	0.44	1										
5 Post-THAAD	0.00	0.06	0.01	0.00	1									
6 Large firm	-0.04	0.02	-0.03	0.00	-0.24	1								
7 Subnational institutional weakness	-0.29	-0.28	-0.33	-0.39	-0.03	0.01	1							
8 Labor resource	0.12	0.13	0.41	0.48	0.00	0.00	-0.39	1						
9 Top industry	0.16	0.04	0.43	0.08	-0.02	0.01	-0.15	0.15	1					
10 Special economic zone	0.20	0.23	0.50	0.59	0.00	0.00	-0.47	0.46	0.14	1				
11 Cultural tightness	0.35	0.42	0.52	0.62	0.00	0.00	-0.34	0.31	0.25	0.50	1			
12 GDP per capita	0.42	0.45	0.39	0.46	0.26	-0.05	-0.49	0.24	0.22	0.24	0.63	1		
13 Highway per area	0.20	0.22	0.15	0.19	-0.03	-0.01	-0.39	0.22	0.08	0.33	0.19	0.20	1	
14 Geographic distance	-0.35	-0.40	-0.14	-0.24	0.00	0.00	0.57	-0.03	-0.11	-0.30	-0.51	-0.59	-0.27	1
Mean	11.16	14.39	250.42	405.23	0.52	0.15	-5.54	6.00	0.07	5.42	2.98	10.77	0.95	6.83
SD	30.15	35.70	648.08	773.61	0.50	0.36	2.68	2.83	0.26	4.21	1.00	0.41	0.83	0.46
VIF	1.65	1.77	2.26	2.47	1.27	1.07	2.28	1.65	1.29	2.36	3.01	3.01	1.26	2.65

Note: $N = 4,278$. The correlations are significant at 5% when the absolute values are greater than 0.03. Abbreviations: THAAD, Terminal High Altitude Area Defense; VIF, variance inflation factor.

TABLE 2 Conditional logit model estimations: Country-of-origin agglomeration, THAAD dispute and location choice during 2013–2018

1	2	3	4		5		6		7	
			H1: THAAD		H2: Firm size		Strong		Weak	
Controls only		Main effects of agglomeration		Small	Large	H3: Subnational institution				
Agglo: Korean, same and related industries × post-THAAD		0.621 (0.156).000	0.554 (0.181).002	1.307 (0.754).083	−1.774 (1.237).152	0.716 (0.211).001				
Agglo: Korean, unrelated industries × Post-THAAD		0.228 (0.114).045	0.302 (0.143).035	−0.319 (0.194).100	0.411 (0.450).361	0.163 (0.146).264				
Agglo: Non-Korean, same and related industries × post-THAAD		−0.062 (0.205).763	−0.170 (0.241).479	0.891 (0.891).318	0.625 (0.543).249	1.041 (0.706).140				
Agglo: Non-Korean, unrelated industries × post-THAAD		−0.103 (0.141).465	−0.061 (0.169).717	−0.446 (0.265).092	−1.053 (0.416).011	0.177 (0.248).474				
Agglo: Korean, same and related industries	0.220 (0.073).003	−0.073 (0.102).477	−0.047 (0.114).680	−0.249 (0.325).444	0.579 (0.290).046	−0.105 (0.115).361				
Agglo: Korean, unrelated industries	0.299 (0.067).000	0.091 (0.081).261	0.070 (0.101).487	0.262 (0.135).051	−0.417 (0.356).242	0.198 (0.071).006				
Agglo: Non-Korean, same and related industries	−0.284 (0.126).025	−0.252 (0.147).087	−0.178 (0.156).253	−1.242 (1.009).218	−0.070 (0.308).821	−1.877 (0.725).010				
Agglo: Non-Korean, unrelated industries	0.033 (0.111).768	0.059 (0.118).619	−0.004 (0.132).973	0.093 (0.273).733	0.671 (0.433).121	−0.429 (0.175).014				
Subnational institutional weakness	0.023 (0.039).555	−0.062 (0.043).148	−0.076 (0.044).083	−0.046 (0.048).341	−0.394 (0.175).025	−1.259 (0.406).002	−0.034 (0.049).483			
Labor resource	−0.163 (0.049).001	−0.225 (0.069).001	−0.229 (0.067).001	−0.294 (0.083).000	−0.110 (0.112).323	−0.034 (0.155).825	−0.209 (0.094).026			
Top industry	−0.833 (0.417).046	0.053 (0.443).905	0.124 (0.433).775	−0.242 (0.486).619	0.856 (0.747).252	1.638 (0.948).084	0.237 (0.462).608			

TABLE 2 (Continued)

	1	2	Main effects of agglomeration		3	H1: THAAD		H2: Firm size		H3: Subnational institution	
			Controls only	HI: THAAD		Small	Large	Strong	Weak		
Special economic zone	0.121 (0.019).000	0.131 (0.031).000	0.129 (0.031).000	0.168 (0.031).000	0.082 (0.037).000	0.082 (0.090).361	-0.011 (0.078).888	0.204 (0.037).000			
Cultural tightness	1.109 (0.195).000	0.905 (0.173).000	0.970 (0.181).000	1.304 (0.209).000	0.380 (0.386).324	1.603 (0.717).025	1.024 (0.229).000				
GDP per capita	0.457 (0.333).170	1.024 (0.416).014	1.108 (0.443).012	1.324 (0.580).022	2.076 (1.165).075	-1.365 (1.557).381	1.879 (0.534).000				
Highway per area	0.219 (0.045).000	0.064 (0.069).352	0.013 (0.066).846	-0.378 (0.351).282	0.273 (0.107).011	0.454 (0.251).071	-0.018 (0.089).837				
Geographic distance	-0.294 (0.253).246	0.934 (0.379).014	0.954 (0.388).014	0.810 (0.447).070	2.495 (0.989).012	-1.750 (1.498).243	1.079 (0.477).024				
Observations	4,278	4,278	4,278	3,627	651	1,271	3,007				
No. establishments	138	138	138	117	21	41	97				
Pseudo R-squared	.231	.301	.346	.409	.185	.540	.428				
Log likelihood	-364.6	-331.1	-310.2	-237.4	-58.8	-64.7	-190.7				
Wald test for aggro: Korean firms in same/related industries × post-THAAD				Model 4 vs. 5		Model 6 vs. 7					
				$\chi^2 = 0.98, p = .32$		$\chi^2 = 4.00, p = .05$					
Wald test for aggro: Korean firms in unrelated industries × post-THAAD				Model 4 vs. 5		Model 6 vs. 7					
				$\chi^2 = 6.83, p = .01$		$\chi^2 = 0.28, p = .60$					

Note: SE in parentheses, p-values in italics.

Abbreviation: THAAD, Terminal High Altitude Area Defense.

[Correction made on 17 January 2023 after first online publication: Table 2 layout has been corrected in this version.]

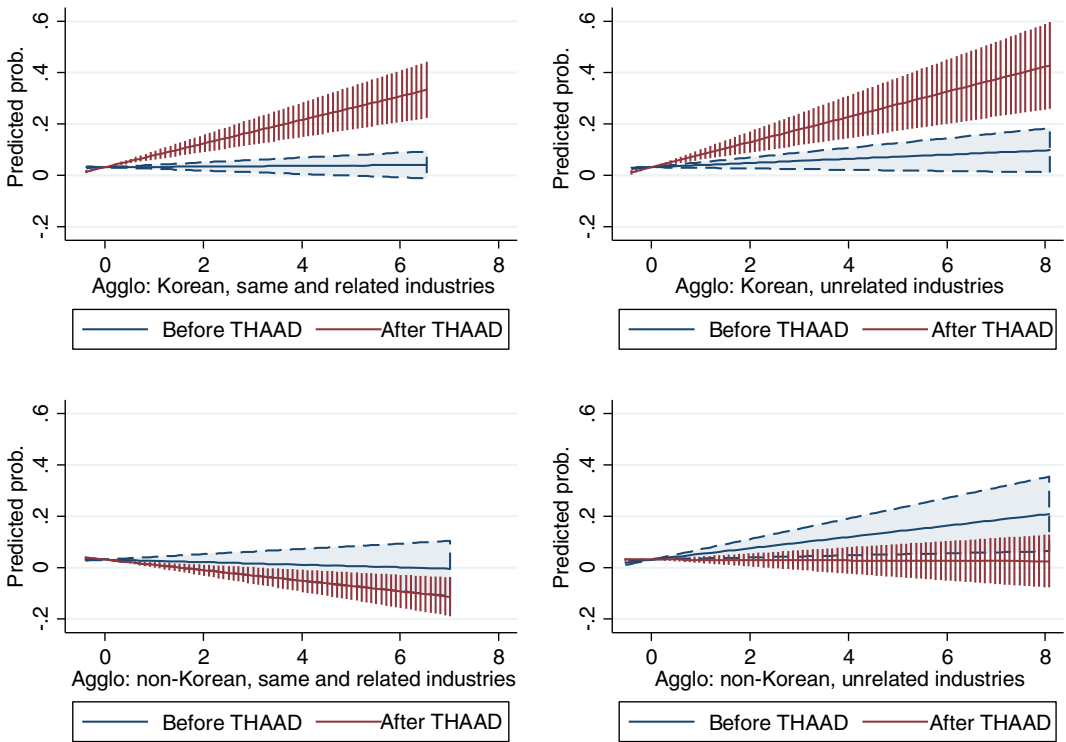


FIGURE 1 Agglomeration and location choice: Before Terminal High Altitude Area Defense (THAAD) dispute (2013–2015) and after THAAD dispute (2016–2018). The band refers to the 95% confidence interval

odds of choosing this location by 24.6%, and 1 *SD* increase in *Korean-firm agglomeration in unrelated industries* in a location increases the odds of choosing this location by 34.9%.

H1 suggests that the positive effect of country-of-origin agglomeration on the attractiveness of a location will be stronger after the THAAD dispute than before the dispute. In Model 3 of Table 2, the interaction term between the post-THAAD dummy and *Korean-firm agglomeration in same and related industries* is positive and statically significant ($b = .621, p < .001$). The interaction term between *Korean-firm agglomeration in unrelated industries* and the post-THAAD dummy is also positive and significant ($b = .228, p = .045$). The odds of choosing a location with *Korean-firm agglomeration in same and related industries* is 86.1% higher in the post-THAAD period than in the pre-THAAD period, and the corresponding number is 25.6% for choosing a location with *Korean-firm agglomeration in unrelated industries*. These results suggest that *Korean-firm agglomeration* (in the same/related and unrelated industries) is more attractive to new Korean establishments after the diplomatic dispute, which seems to suggest that the collective action benefits of *Korean-firm agglomeration* outweigh the costs when compatriot MNEs face a common environmental threat. In comparison, the two interaction terms between the post-THAAD dummy and non-Korean-firm agglomeration in same/related industries and in unrelated industries are negative and insignificant ($b = -.062, p = .763$; $b = -.103, p = .465$, respectively), suggesting that non-Korean-firm agglomeration is not more appealing to Korean firms after the THAAD dispute than before the dispute. This indicates that non-Korean-firm agglomeration does not offer the kind of collective gains that *Korean-firm agglomeration* does for new Korean establishments. Taken together, these results offer strong support for H1 that a

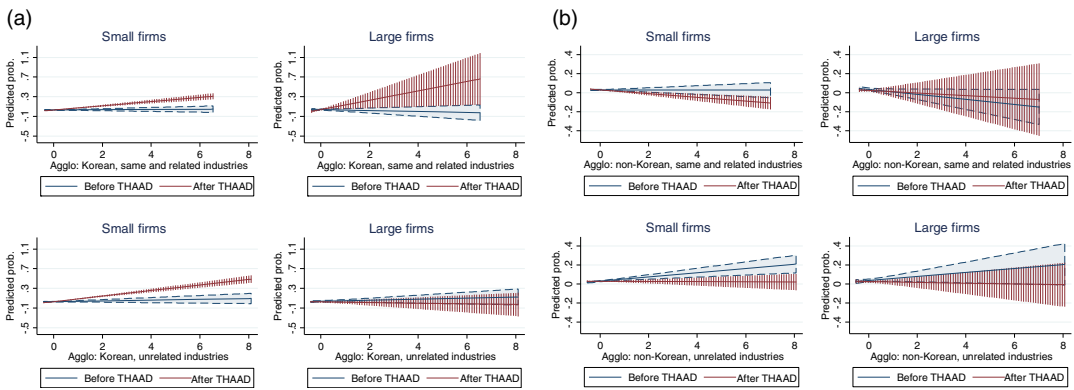


FIGURE 2 (a) Korean-firm agglomeration, Terminal High Altitude Area Defense (THAAD) dispute, and location choice: Small versus large firms. (b) Non-Korean-firm agglomeration, THAAD dispute, and location choice: Small versus large firms. The band refers to the 95% confidence interval

location with greater country-of-origin agglomeration is more attractive to new Korean establishments after the THAAD dispute.

Since the coefficient estimates alone may not accurately capture the interaction effects in a non-linear model such as conditional logit (Hoetker, 2007), we gauge the magnitude of the interaction effects visually (Figure 1). Because the estimates are conditional in nature, one cannot obtain “average” probability predictions as in unconditional models. In particular, conditional logit models do not allow direct estimation of firm fixed effects which are necessary for the firm-level prediction of probabilities (Allison, 2009). We thus employ linear probability models (LPM) to replicate the estimations in Table 2 and report the results in Table A3 of the Appendix, which are consistent with those in Table 2, offering further support for Hypothesis H1.

Figure 1 is based on the LPM estimation results in Model 3 of Table A3 in the Appendix. It presents the predicted probabilities of location choice depending on the values of Korean and non-Korean firm agglomeration in the pre- and post-THAAD periods. In the top two figures, the curves are upward-sloping for the relationship between Korean-firm agglomeration both in same/related (top left figure) and in unrelated industries (top right figure) and location choice for new establishments, and the curves are steeper in the post-THAAD period than in the pre-THAAD period, suggesting that both types of country-of-origin agglomeration have a more positive effect on location choice after the THAAD dispute. In comparison, the bottom two figures show that the curves are overlapping for non-Korean-firm agglomeration in same/related industries and in unrelated industries, suggesting no clear-cut patterns. These results provide further support for H1.

H2 posits that the relationship in H1 is more salient for small firms than for large firms. Models 4 and 5 of Table 2 report the conditional logit estimations. The interaction term between Korean-firm agglomeration in same/related industries and the post-THAAD dummy is positive and significant for both small firms ($b = .554$, $p = .002$ in Model 4) and large firms ($b = 1.307$, $p = .083$ in Model 5). A Wald test suggests no significant difference between these two coefficients ($\chi^2 = 0.98$, $p = .32$). Thus, Korean-firm agglomeration in same/related industries matters for both small and large firms after the THAAD dispute. It appears that the net benefits of collective actions with proximate or rival firms may be substantial enough that even

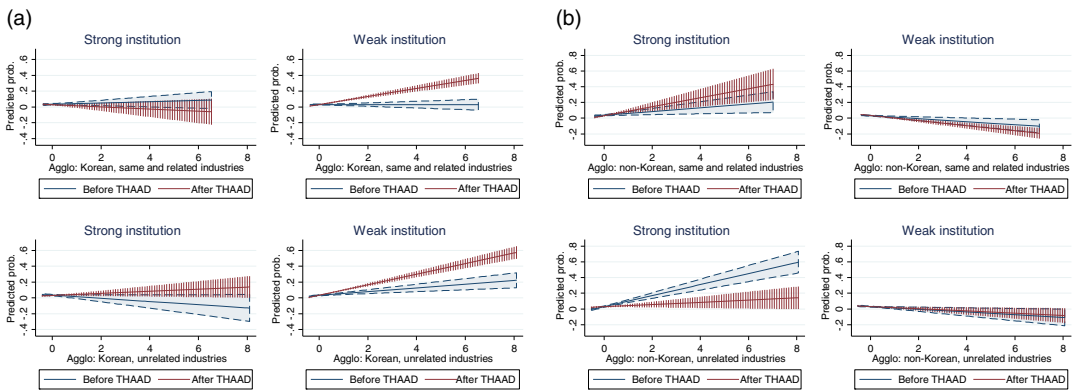


FIGURE 3 (a) Korean-firm agglomeration, Terminal High Altitude Area Defense (THAAD) dispute, and location choice: Strong versus weak subnational institutions. (b) Non-Korean-firm agglomeration, THAAD dispute, and location choice: Strong versus weak subnational institutions. The band refers to the 95% confidence interval

large firms tend to rely on agglomeration to deal with regulatory challenges after the THAAD dispute. We therefore do not find evidence to support Hypothesis H2 based on Korean-firm agglomeration in same/related industries. By comparison, the interaction term between Korean-firm agglomeration in unrelated industries and the post-THAAD dummy is positive and significant only for small firms ($b = .302, p = .035$). A Wald test indicates that the effect is greater on small firms' location choice than on large firms' location choice after the THAAD dispute ($\chi^2 = 6.83, p = .01$). Thus, we find evidence to support H2 based on Korean-firm agglomeration in unrelated industries. [Correction made on 17 January 2023 after first online publication: In the preceding sentence, the word Hypothesis has been deleted in this version.]

The LPM estimation results for small and large firms are summarized in Models 4–5 of Table A3 in the Appendix. The Wald test results for Hypothesis H2 based on LPM are consistent with those based on conditional logit models. Figure 2a graphs the LPM estimation results for the impact of Korean-firm agglomeration. For small firms (the left two figures of Figure 2a), the upward-sloping curve is steeper in the post-THAAD period than in the pre-THAAD period for Korean-firm agglomeration in same/related industries (the top left figure) and in unrelated industries (the bottom left figure). For large firms (the right two figures), however, the difference between pre- and post-THAAD period is not as evident. In comparison, Figure 2b, which graphs the impact of non-Korean-firm agglomeration, does not show clear patterns for small Korean firms. The contrasting results in Figure 2a,b indicate clearly that Korean-firm agglomeration, not agglomeration of firms from other countries of origin, matters more for small Korean firms' location choice after the THAAD dispute. These comparisons lend more credence to H2.

H3 posits that the positive effect of country-of-origin agglomeration on location choice of MNEs is more salient for entry into regions with weaker institutions. Regions with Korean investments are categorized as having strong or weak institutions based on the median value of subnational institutional weakness in the year before the establishment of new Korean subsidiaries. Models 6 and 7 of Table 2 present the results. The interaction term between Korean-firm agglomeration in same/related industries and the post-THAAD dummy is positive and significant for new establishments in regions with weak subnational institutions ($b = .716, p = .001$) but negative and insignificant in regions with strong subnational institutions ($b = -1.774, p = .152$). The difference is statistically significant ($\chi^2 = 4.00, p = .05$). This result suggests that the net benefits of collective actions with proximate or rival firms may be higher when firms face higher regulatory burden after the THAAD dispute in regions with weak subnational institutions. The

interaction term between Korean-firm agglomeration in unrelated industries and the THAAD dummy is positive but insignificant for firms under both strong ($b = .411$, $p = .361$) and weak ($b = .163$, $p = .264$) subnational institutions. The difference is statistically insignificant ($\chi^2 = 0.28$, $p = .60$). Thus, we find evidence to support H3 based on Korean-firm agglomeration in same/related industries. [Correction made on 17 January 2023 after first online publication: In the preceding sentence, the word Hypothesis has been deleted in this version.]

The LPM estimations are summarized in Models 6–7 of Table A3 in the Appendix. The Wald test results for H3 based on LPM are consistent with those based on conditional logit models. Figure 3a graphs the LPM estimation results for the effects of Korean-firm agglomeration. In regions with weak institutions (the right two figures of Figure 3a), the upward-sloping curve is steeper in the post-THAAD period than in the pre-THAAD period for Korean-firm agglomeration in same/related industries (the top right figure) and in unrelated industries (the bottom right figure). In regions with strong institutions (the left two figures), however, the overlapping curves indicate that the difference between the pre- and post-THAAD periods is not evident. Figure 3b, which illustrates the effects of non-Korean-firm agglomeration, shows no clear pattern in regions with weak institutions (the right two figures). The contrasting results in Figure 3a,b indicate that Korean-firm agglomeration, not agglomeration of firms from other countries of origin, matters more for Korean firms' location choice in regions with weak institutions after the THAAD dispute. Therefore, the graphs show further support for H3.

4.1 | Robustness tests

4.1.1 | Endogeneity concerns and two-stage models

One might be concerned that regional factors such as economic conditions and institutional quality may drive both Korean-firm agglomeration and location choice for new Korean establishments. We have controlled for common regional characteristics to mitigate this concern. Further, we run 2SLS regressions with an instrumental variable, the number of Korean Chinese (Chaoxian) in each region (Li et al., 2019), to address the potential endogeneity issue about Korean-firm agglomeration. Results in Table A4 of the Appendix are consistent with the main results in Table 2 and offer further support for H1, H2, and H3.

4.1.2 | Collective action mechanisms

Our hypotheses are built on the idea that the nonmarket benefits of country-of-origin agglomeration are realized through collective actions of colocated compatriot MNEs. We perform two sets of robustness analyses to further examine the (a) role of country-based business associations as a specific channel for collective action, and (b) case of competition where coordination problems are particularly severe for collective action. Our results hold with these additional analyses. See Table A5 in the Appendix for details.

4.1.3 | Alternative interpretations

First, our fine-grained measures of agglomeration help us tease out alternative explanations such as resource and knowledge sharing with market forces. See the Appendix for more

discussion. Second, learning from the initial entry does not appear to drive the observed relationships between agglomeration, post-THAAD dummy, and MNEs' location choice. See Models 1–5 of Table A6 in the Appendix for details. Third, we conduct a “parallel trend” analysis (Figure A1 in the Appendix) and explore alternative measures for various variables (see Tables A7, A8a,b, A9, and A10a,b in the Appendix). For the firm size variable, future studies may develop more sophisticated measures of resource endowment or constraint.

5 | DISCUSSION AND CONCLUSION

This study examines how country-of-origin agglomeration affects MNEs' location choice in a host country. We conceptualize that country-of-origin agglomeration facilitates collective actions and creates collective gains for compatriot MNEs in their interactions with a key non-market factor, the host government. Accordingly, we hypothesize that compatriot MNEs will be more inclined to locate in places with country-of-origin agglomeration when they face higher regulatory burden in the host country. For empirical analysis, we employ an exogenous diplomatic dispute between the MNEs' home and host countries that aggravates regulatory challenges for the MNEs in the host country. In such an adverse environment, MNEs are in greater need of country-of-origin agglomeration to take collective actions to buffer themselves from the adverse institutional environment. After controlling for various economic, infrastructural, cultural, and institutional factors, we find that country-of-origin agglomeration is particularly attractive to Korean MNEs after the THAAD dispute than before the dispute. We further identify the boundary conditions where MNEs are in an even greater need of country-of-origin agglomeration after the THAAD dispute. Our findings suggest that after the THAAD dispute, country-of-origin agglomeration has a stronger effect for smaller MNEs and in regions with weaker institutions. These results remain robust with different measures, samples, and empirical methods. Overall, we find evidence to support the key idea that country-of-origin agglomeration is attractive to new establishments as it helps MNEs deal with regulatory burden imposed by the host environment.

Our study contributes to research on agglomeration. Existing literature suggests that the primary source of benefits from country-of-origin agglomeration lies in resource and knowledge sharing among compatriot MNEs, which mitigates transaction costs and improves economic efficiency in interactions with market forces (Belderbos et al., 2011; Chang & Park, 2005; Tan & Meyer, 2011; Zaheer et al., 2009). Our study offers a different perspective, proposing that conational agglomeration enables collective actions and creates collective gains for MNEs to engage the host government.

Our core empirical finding that Korean MNEs are more attracted to host locations with country-of-origin agglomeration after the THAAD dispute cannot be easily explained by other mechanisms discussed in the literature. In dealing with the ramifications of a diplomatic dispute, an MNE needs to engage the host government (a nonmarket force) that sets the rules of the game. The traditional focus on market interactions and efficiency considerations is insufficient to explain our finding that locations with country-of-agglomeration are more attractive to MNEs after a diplomatic dispute than before. Alternative mechanisms such as herding and imitation are similarly less plausible in our context. Herding suggests that if a focal MNE observes that compatriot MNEs are clustered in a location and believes that they have taken the right course of action with some information advantages, the MNE will follow compatriot MNEs to that location (Banerjee, 1992; Gaba & Terlaak, 2013). Because of the exogenous nature of the

diplomatic shock, incumbents likely do not have substantial information or knowledge advantages over new entrants about the right course of actions. Imitation suggests that a new entrant may imitate the location choice of compatriot MNEs because they are considered more legitimate or better in the local market than a new entrant (DiMaggio & Powell, 1983). Yet incumbents are not necessarily more legitimate in the eyes of the host government during the periods of diplomatic tensions. In fact, incumbents are typically the first victims of adverse policy changes. News reports show that incumbents such as Hyundai and Lotte suffered significant sales losses after the THAAD dispute (South China Morning Post, 2017). For these reasons, we believe that the effect of agglomeration on location choice in the presence of the THAAD dispute is less likely driven by imitation or herding (Belderbos et al., 2011; North, 1984; Zhang, Li, & Li, 2014). A more plausible explanation, as we have proposed, is that agglomeration allows compatriot MNEs to use colocation to engage the host government in an attempt to navigate the adverse institutional environment.

Our study contributes to the collective action research (Olson, 1965; Ostrom, 1990) by contextualizing the collective action arguments to understand the impact of country-of-origin agglomeration and identifying the boundary conditions under which the benefits of collective actions exceed the costs. Our findings show that common environmental threats such as adverse diplomatic shocks are an important boundary condition; even though taking collective actions with compatriot MNEs, especially competitors, can be costly, MNEs are willing to do so when they face common environmental threats.

This study extends the international business research on MNEs' nonmarket strategies to cope with adversity in the institutional environment. We suggest that besides the micro-firm level and macro-country level strategies emphasized by the existing literature, MNEs can achieve collective gains from a meso-group level. The international business literature suggests that firms can rely on their firm-specific advantages such as size, financial resources, technological, and advertising expertise, and export intensity to gain advantage in their engagement with the host government (Fagre & Wells, 1982; Lecraw, 1984; Moon & Lado, 2000). Firms can also transfer political capabilities they develop at home to the host market, form alliances with other firms, and cultivate political ties with local governments to handle political risk in a foreign country (Holburn & Zelner, 2010; Li & Zhang, 2007; Peng & Luo, 2000; Sun et al., 2021). In addition, literature has suggested that MNEs' home and host countries can engage in bargaining and sign bilateral or multilateral agreements to protect the interests of their own firms doing business in each other's country (Albino-Pimentel, Dussauge, & Shaver, 2018; Ramamuriti, 2001). Our study suggests a group-level strategy based on the argument that collocating with peer firms from the same home country can enable collective action and bring about collective gains for MNEs to interact with the host environment. This nonmarket strategy adds value for MNEs investing in an adverse institutional environment, particularly for small MNEs that tend to be resource-constrained and in regions with weak formal institutions.

Our research context provides numerous benefits such as an exogenous shock leading to regulatory burden for MNEs from a specific home country. Nevertheless, our focus on two countries has its limitations. We encourage future research to consider more home and host countries to examine the generalizability of the findings. For example, information on firm-level foreign investments from other countries (besides South Korea) in China may be gathered to examine whether firms from other countries also tend to locate near their conational peers in response to regulatory burden. It is possible that Korean firms, with their collective cultures, are more inclined to take collective actions for collective gains.

Our arguments are built on the proposition that collocation of compatriot MNEs enables collective action and creates collective gains. We gathered qualitative evidence (e.g., interviews) and conducted robustness tests to get closer to the collective action mechanism. Nevertheless, we did not directly measure or test the collective action mechanism or the collective gains. Granted, MNEs and the host government may interact behind the doors and the outcomes may not always be observable. Still, future empirical research may shed further light by analyzing the collective action mechanism and the collective gains. We hope our theoretical perspective on the nonmarket benefits of agglomeration can spur more research in the areas of agglomeration and MNE strategies.

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DATA AVAILABILITY STATEMENT

The data on the location of Korean new establishments in China that support the findings of this study are available from KOTRA at https://dream.kotra.or.kr/kotranews/cms/com/index.do?MENU_ID=1350.

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Additional supporting information can be found online in the Supporting Information section at the end of this article.

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