DOES IMITATION REDUCE THE LIABILITY OF FOREIGNNESS?

LINKING DISTANCE, ISOMORPHISM, AND PERFORMANCE

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ABSTRACT

Research demonstrates that foreign firms imitate the practices of domestic firms (i.e., adopt an isomorphism strategy) in an attempt counteract the deleterious performance consequences associated with institutional distance. However, studies linking isomorphism to performance generally treat isomorphism as exogenous. In this study, we treat isomorphism as an endogenous strategy taken with its performance consequences in mind. Using a dataset of 80 foreign banks from 25 host countries operating in the United States, we find that foreign firms from institutionally distant home countries benefit more from selecting an isomorphism strategy than they would have had they not chosen such a strategy; however, the performance benefits associated with isomorphism erode as institutionally distant firms gain experience in the host country.

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INTRODUCTION

International strategy scholars have long recognized that foreign firms face disadvantages vis-à-vis indigenous firms (Hymer, 1960; Zaheer, 1995). This disadvantage arises because foreign firms originate from countries that differ, often markedly, from the host country. Foreign firms are at an informational disadvantage, face greater levels of uncertainty, share fewer ties with local agents, and incur greater operational and coordination costs. This disadvantage is known as the 'liability of foreignness' (Zaheer, 1995), and it has been demonstrated to negatively impact foreign subsidiary performance (Zaheer, 1995; Zaheer and Mosakowski, 1997).

In an attempt to overcome the liability of foreignness, firms adopt mitigating strategies. One such strategy is to imitate elements of the strategies and practices of local, domestic competitors—i.e., to adopt a strategy of local isomorphism (Zaheer, 1995). Indeed, organizational scholars suggest that firms often adopt isomorphic strategies in situations characterized by uncertainty and information asymmetry (e.g., DiMaggio and Powell, 1983; Haunschild, 1993; Henisz and Delios, 2001). By conforming to prevailing local norms, firms adopt practices that better fit the local institutional environment. This can help firms acquire legitimacy, thereby offsetting initial disadvantages.

The question of interest then is whether local isomorphism translates into performance benefits for firms that adopt such a strategy. Although research examines the performance consequences of adopting such strategies in a domestic setting (e.g., Deephouse, 1996, 1999; Barreto and Baden-Fuller, 2006; Sirmon and Hitt, 2009), there have been fewer such studies in an international context, with Rosenzweig and Nohria (1994), Zaheer (1995), and Miller and Eden (2006) as notable exceptions.

Whether in an international or domestic context, studies that examine the relationship between local isomorphism and performance generally share one common characteristic: they treat isomorphism as an exogenous determinant of firm performance. Those that study the antecedents of isomorphism, however, note that isomorphism is a managerial decision. Managers likely anticipate the effects of isomorphism on performance and are more likely to select such a strategy when its anticipated benefits exceed its costs (see Shaver, 1998). In the context of international expansion, isomorphism might therefore be beneficial for some subset of foreign firms, but not for others.

Although studies in international strategy increasingly address the performance consequences of endogenously selected strategies, (see Shaver, 1998; Brouthers, Brouthers, and Werner, 2003, 2008; Sirmon and Hitt, 2009; and He, Brouthers, and Filatotchev, 2013), this approach has not been extended to the link between isomorphism and performance. To fill this gap, we treat isomorphism as an endogenous, firm-selected outcome that stands to impact performance. Specifically, we argue that foreign firms are likely to base their local isomorphism decisions on the institutional (cultural, economic, political, and regulatory) distance between the host country and their home country (e.g., Salomon and Wu, 2012). We subsequently argue that firms that make local isomorphism decisions based on institutional distance perform better than they would have had they not chosen such a strategy. In this sense, we expect that selecting a strategy of local isomorphism when conditions warrant leads to better performance outcomes.

We test our theory using a dataset of 170 foreign bank subsidiaries established by 80 foreign banks from 25 countries operating in the United States between 1978 and 2006. We adopt a two-stage modeling approach to address the endogeneity of local isomorphism. We find that when the institutional distance between the home country and the United States is greater, firms that initially opt for local isomorphism perform better than they would have had they not selected such a strategy. However, foreign firms from institutionally distant

countries benefit most from isomorphism when they lack experience in the host country. As firms gain experience in the local market, the benefits of local isomorphism dissipate.

This study makes several contributions to the strategy, international business, and organization literatures. First, it explicitly treats isomorphism as an endogenous strategic decision adopted by foreign firms depending upon the institutional distance between the host and home countries. By adopting this approach, we can more accurately identify the links that bind institutional distance, local isomorphism, and foreign subsidiary performance. Second, this work adds to existing studies of isomorphism and performance by exploring the conditions under which the impact of isomorphism might change. That is, it demonstrates that the benefits associated with isomorphism erode as foreign firms gain experience in the local market. Third, by examining how performance amongst foreign entrants varies in institutional distance, we enhance the literature on the liability of foreignness. Specifically, we complement, and extend, findings that simply demonstrate that foreign firms perform worse than domestic firms. Though consistent with previous findings, our study links distance to performance, demonstrating that foreign firms from institutionally distant countries perform worse than do foreign firms from institutionally similar countries. Finally, by treating institutional distance as a multi-dimensional construct comprised of cultural, political, economic, and regulatory dimensions, we heed recent calls to adopt a more nuanced approach to distance (see Berry, Guillén and Zhou, 2010; Bae and Salomon, 2010). This adds to our understanding of the factors underpinning the liability of foreignness.

The rest of this paper proceeds as follows: The next section reviews prior literature on the antecedents and consequences of a local isomorphism strategy, and based on this review we develop hypotheses. The following section describes the data and methodology we use to test the hypotheses. We subsequently present results, discuss the findings, and conclude.

LITERATURE REVIEW

Research from a variety of disciplines suggests that there are specific situations in which firms will imitate the strategies of others. For example, Nelson and Winter (1982) claim that firms have an incentive to imitate the practices of competitors in an attempt to improve their own performance. Assuming that firms are boundedly rational (Simon, 1955), they argue that managers are likely to look to others when they find themselves in situations in which it is difficult to calculate precisely the economic return associated with selected strategies. Firms facing such uncertainty may therefore imitate the practices of others in an 'attempt to duplicate imperfectly observed success' (Nelson and Winter, 1982: 123).

In the information economics literature, Banerjee (1992) and Bikhchandani, Hirshleifer, and Welch (1992) demonstrate how herding behavior, where economic actors imitate each other, can arise when information is subject to cascades (i.e., economic actors are privy to the decisions of others that come before them). In such a situation, firms (as the economic actors of interest) imitate others because they give more weight to the information imparted by the actions of others than to their own private information. Stated differently, assuming that others have better private information, this view asserts that firms might prefer to imitate others instead of making independent choices based on their information alone.

Institutional theorists explain the widespread dispersion/imitation of practices (i.e., isomorphism) as the outcome of a process by which firms attempt to acquire legitimacy. According to this perspective, firms imitate the strategies and practices of others because constituents widely view those strategies/practices as legitimate (Meyer and Rowan, 1977). Firms may face coercive pressures to imitate the practices of others, ceremonially adopt normative practices, and/or engage in such behavior because the practices are viewed as beneficial (DiMaggio and Powell, 1983).

Whatever the motivation, myriad studies demonstrate that firms imitate each other in a variety of contexts. For example, Haunschild and Miner (1997) and Baum, Li, and Usher (2000) demonstrate that when the environment is characterized by uncertainty, firms look to competitors for clues to help reduce uncertainty. More specifically, they find that nursing

home chains imitate the acquisition strategies of larger competitors and of competitors that share characteristics similar to their own. Haveman (1993) finds that California thrifts imitate the strategies of successful competitors when entering new markets, in hopes of replicating their success. Hong, Kubik, and Solomon (2000) demonstrate how inexperienced security analysts are more likely to adopt, and conform to, consensus forecasts. Palmer, Jennings, and Zhou (1993) find that institutional isomorphism explains the diffusion of the multidivisional form among large U.S. industrial corporations. Westphal, Gulati, and Shortell (1997) show that U.S. hospitals succumb to normative pressures when adopting TQM practices.

Scholars have not only examined the various antecedents of isomorphic behavior, but they have also examined the legitimacy and/or performance consequences of adopting isomorphism strategies. For example, Sirmon and Hitt (2009) find that bank performance is enhanced when a bank imitates the investment patterns of rivals. Deephouse (1996) finds that U.S. commercial banks that conform to broad industry asset strategies acquire more legitimacy in the form of regulatory, and public media, endorsement. In a follow-on study, Deephouse (1999) finds an inverted U-shaped link between isomorphism and financial performance. Barreto and Baden-Fuller (2006) find that Portuguese banks often imitate the locational patterns of their competitors, despite the relative unattractiveness of those locations, and despite the fact that such behavior does not positively affect bank profitability. In a non-banking context, Staw and Epstein (2000) demonstrate that firms adopting popular management techniques are viewed as more legitimate and reputable, though their performance is not necessarily better. Similarly, Kennedy (2002) finds that television networks follow other networks in adopting new programming, despite uncertain performance consequences.

Although there is now an extensive body of work examining the antecedents and consequences of isomorphic strategies, the overwhelming majority of extant studies focus on domestic firms, with a few notable exceptions. Insofar as antecedents are concerned, Rosenzweig and Nohria (1994) discovered that the subsidiaries of multinational firms often

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imitate the human resource practices of firms in the host countries in which they operate. Similarly, Henisz and Delios (2001) demonstrate that Japanese firms that are at an informational disadvantage in the host country tend to imitate the entry decisions of similar others. More generally, Salomon and Wu (2012) find that foreign firms are increasingly likely to engage in local isomorphism and imitate the strategies and practices of local competitors as the institutional distance between the host and home country increases.

With respect to performance, Zaheer (1995) studies trading rooms and finds that foreign firms that imitate the practices of domestic competitors do not experience improved performance. Miller and Eden (2006) add nuance to Zaheer's (1995) findings. Miller and Eden (2006) postulate that the performance consequences of isomorphism will depend on the nature of the local competition. They find that isomorphism correlates positively to performance when there are fewer competitors in the local market, and correlates negatively to performance when there are a greater number of competitors in the local market.

Although both of the aforementioned studies have enriched our understanding of the relationship between isomorphism and the performance of foreign firms in the host market, neither explicitly accounts for the underlying reasons as to why firms might choose an isomorphism strategy in the first place.[1] Likewise, to our knowledge, the domestic performance studies described here do not explicitly account for isomorphism's antecedents; they treat isomorphism as exogenous. We know from prior research, however, that firms often adopt isomorphism strategies with legitimacy/performance benefits in mind. Therefore, to gain greater insight into the performance benefits of isomorphism, it helps to account for the circumstances under which firms choose such strategies.

The next section develops theory regarding international expansion, isomorphism, and firm performance. We pay special attention to the institutional differences between the host and home country, and how such institutional differences impact the selection of

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[1] Although Miller and Eden (2006) do not explicitly account for the first stage selection of isomorphism, they do include firm fixed effects in their performance analysis. Their results are therefore less subject to an endogeneity bias.

isomorphism strategies. Given the institutional antecedents of isomorphism, we then build hypotheses regarding the likely effect of isomorphism on firm performance. We subsequently qualify the theory to discuss the differential benefits of adopting isomorphism for experienced, versus inexperienced, firms.

HYPOTHESES

Institutional distance, liability of foreignness, and performance

One important distinction between domestic firms and foreign firms operating in the local market is that the latter originate from countries in which the institutional environment differs, often markedly, from that of the host country. By institutional environment we refer to North's (1991: p. 97) conceptualization of national institutions as 'humanly devised constraints that structure political, economic, and social interaction...[and that] provide the incentive structure of an economy…' Accordingly, one can fruitfully describe the institutional environment of any nation as comprised of cultural, economic, political, and regulatory components (see Bae and Salomon, 2010; Berry *et al*., 2010).

The differences in institutional (cultural, political, economic, and regulatory) context that firms face when operating across national borders are referred to generically as institutional distance, and such distance puts foreign firms at a disadvantage vis-à-vis indigenous firms (Kostova and Zaheer, 1999; Xu and Shenkar, 2001). This disadvantage is known as the 'liability of foreignness' (Zaheer, 1995). The liability of foreignness manifests as additional costs to foreign firms operating in the local market. The costs include those related to additional coordination, transaction, labor, start-up, legal, legitimacy, and others that stem from a broad unfamiliarity with the local institutional environment (Hymer, 1960; Johanson and Vahlne, 1977; Hennart, 1982; Lipsey, 1994; Zaheer, 1995; Mezias, 2002; Salomon and Martin, 2008).

Because institutional distance imposes additional costs to foreign firms operating in the host market, foreign entrants often experience difficulty selecting and implementing

effective strategies in the local market. Their performance, predictably, suffers. As the literature demonstrates, the additional costs imposed by the liability of foreignness negatively impacts foreign subsidiary performance and survival. For example, Zaheer (1995) finds that foreign exchange trading rooms are less profitable than their domestic competitors. Likewise, Zaheer and Mosakowski (1997) demonstrate that foreign exchange trading rooms are more likely to exit the business than are those owned by local banks. Similarly, Mata and Freitas (2012) show that foreign firms have a lower survival rate than do similar domestic firms.

Because the liability of foreignness increases in institutional distance (Kostova and Zaheer, 1999; Xu and Shenkar, 2000; Eden and Miller, 2004; Perkins, 2008), it follows that the performance of foreign firms ought, likewise, to correlate negatively to institutional distance. However, we note that, as with studies of isomorphism and performance, studies examining the link between the liability of foreignness and firm performance generally do not account for the manner in which firms choose strategies to offset the impact of distance. Therefore, assuming that firm strategy does not influence the relationship between institutional distance and performance, we expect the performance of foreign firms to decrease in institutional distance. This sets up our unconditional baseline expectation:

> **Baseline Expectation:** *All else equal, foreign firm performance decreases as the institutional distance between the host country and the home country increases.*

Institutional distance and isomorphism

Although we expect institutional distance to exhibit a negative relationship with performance, our baseline expectation does not account for firm efforts to mitigate the impact of distance. To the extent that foreign entrants take institutional distance into account when making strategic decisions, firms might be able to ameliorate its impact on performance.

For example, scholars note that one way foreign firms can reduce the liability of foreignness, and thus offset the impact of distance, is by imitating local competitors—i.e., by adopting a strategy of local isomorphism (Zaheer, 1995; Miller and Eden, 2006; Salomon and

Wu, 2012). By pursuing a strategy of local isomorphism, foreign firms adopt practices that have been demonstrated to "fit" the local environment and thereby improve performance.

To overcome their disadvantage vis-à-vis domestic competitors, foreign entrants need to acquire knowledge about the local market (Johanson and Valhne, 1977; Henisz and Delios, 2001; Li, Poppo, and Zhou, 2010). Since foreign entrants often do not have local experience from which to draw, they rely on local firms as a guide to what works in the local environment (Makino and Delios, 1996). This is because local firms can provide clues on the kinds of strategic behaviors that are appropriate. The practices of local firms can help foreign entrants fill knowledge gaps and identify efficient, profit-maximizing strategies. This helps reduce environmental uncertainty, and by corollary, the liability of foreignness (Makino and Delios, 1996). Indeed, researchers find that foreign firms acquire tacit knowledge about the local market from domestic firms, benefit from their operational expertise, and use them as an operational benchmark (Wei, Liu, and Wang, 2008; Li *et al.*, 2010).

Although not inconsistent with the aforementioned logic, the organizations literature highlights a specific complementary reason for foreign firms to imitate local competitors: to enhance legitimacy. As Kostova and Zaheer (1999) point out, foreign entrants often lack legitimacy in the eyes of local actors. It is therefore critical for foreign entrants to establish themselves as legitimate. Adopting a local isomorphism strategy represents one possible means to acquire such legitimacy (Rosenzweig and Singh, 1991; Zaheer, 1995). By conforming to local norms and practices, foreign firms can achieve regulative, normative and cognitive legitimacy (Meyer and Rowan, 1977; Scott, 1995). This is because domestic firms provide examples of the types of strategies that are compatible with the local cultural, political, economic, and regulatory environment. By imitating them, foreign entrants emulate practices that have been accepted as legitimate, thereby enhancing their own legitimacy.

Irrespective of the specific reason for adopting a local isomorphism strategy (whether for legitimacy or efficiency reasons), Salomon and Wu (2012) suggest that isomorphism should especially benefit entrants from more institutionally (culturally, politically,

economically, and regulatorily) distant markets. Foreign firms from institutionally distant countries are at a greater disadvantage from the outset, while foreign firms from countries that are more institutionally similar to the host country do not bear as great a liability (Kostova and Zaheer, 1999; Xu and Shenkar, 2000; Eden and Miller, 2004; Perkins, 2008). They are at less of an information disadvantage and are less likely to rely on local firms as a model for how to do business in the local market. They need not worry as much about establishing legitimacy in the host nation (Kostova and Zaheer, 1999) and therefore have greater latitude in selecting a strategy. As a result, local isomorphism represents a strategic option that is likely to help foreign firms better adapt to more unfamiliar markets. It also helps them to close the legitimacy gap. By contrast, foreign firms from a similar home country face less uncertainty and should find it easier to understand the host country market. They are less likely to rely on domestic firms as models of appropriate behavior in the host market, and thereby benefit less from imitating domestic competitors.

Taken together, we therefore expect foreign entrants from institutionally distant home countries that imitate local firms to perform better than do those that elect not to imitate the strategies of local firms. By corollary, we expect foreign entrants from institutionally distant home countries that opt for a strategy of local isomorphism to perform better than do foreign entrants from institutionally similar home countries that opt for a local isomorphism strategy. Stated formally:

> **Hypothesis 1:** *All else equal, foreign entrants that select local isomorphism strategies based on their institutional distance profile experience better performance outcomes than those that do not.*

Experience in the Host Country

Although foreign entrants from distant home countries are more likely to imitate the practices of domestic firms, and to derive performance benefits from so doing, this is not to say that those strategies provide value indefinitely. Pursuing a strategy of local isomorphism may, at the outset, offer enhanced value for firms from distant home countries as a means to mitigate

the liability of foreignness. However, over time, and with experience, firms may not only acquire legitimacy organically, but also become more comfortable operating in the host market. In this sense, the liability of foreignness born out of institutional distance may decrease as foreign firms accumulate experience in the host country.

With additional operational experience in the host country, firms acquire an increased, and often tacit, understanding of the local market (Johanson and Valhne, 1977; Henisz and Delios, 2001; Li *et al.*, 2010). They learn about customers, competitors, suppliers, and other institutional actors. For example, they get access to tacit knowledge by establishing trustful links with local firms; they gain an understanding of consumer preferences so as to better respond to customer needs; they become more connected in the local market so as to better anticipate changes in policy; and they learn which of their own practices they might fruitfully extend to the local market (Barkema, Bell, and Jennings, 1996; Delios and Henisz, 2000; Chang and Rosenzweig, 2001; Li *et al.*, 2010). Moreover, as foreign firms from institutionally distant home countries gain operating experience, local actors view them as more legitimate (Zaheer and Mosakowski, 1997). Although foreign entrants from institutionally distant home countries enter with low initial levels of legitimacy, as they increasingly interact with, and build ties to, local institutional actors—such as customers, suppliers, and regulators—they become accepted as legitimate actors.

As foreign firms accumulate greater local knowledge and gain legitimacy, the uncertainty that they initially faced reduces, and this affords them the opportunity to become less reliant on imitative practices (Henisz and Delios, 2001; Salomon and Wu, 2012). A strategy of isomorphism, valuable at first, provides fewer benefits for firms from distant countries with the accumulation of experience and the passage of time. We therefore expect the performance benefits of local isomorphism to diminish in experience for foreign entrants from distant institutional home countries. Otherwise stated, accounting for institutional distance, we expect experience in the host country to negatively moderate the relationship between local isomorphism and foreign firm performance. We hypothesize:

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Hypothesis 2: *All else equal, the positive performance impact of local isomorphism strategies for foreign firms from institutionally distant countries decreases in the host country experience of the foreign firm.*

RESEARCH DESIGN

Data

We study the relationship between local isomorphism and foreign firm performance in the U.S. banking industry. The U.S. banking industry is particularly well suited to such a study because it is highly regulated and banks face strong pressures to conform to the institutional environment (Sponge, 1990; Scott and Meyer, 1991; Deephouse, 1996; Miller and Eden, 2006). It is critical not only for U.S. banks to establish legitimacy (Deephouse, 1996, 1999), but especially for foreign banks to do so (Salomon and Wu, 2012).

To gather banking industry data, we turned to the Reports of Condition and Income (known as the Call Reports) from the Federal Reserve Bank of Chicago. The Call Reports capture financial and structural information for foreign and domestic commercial banking institutions. We rely on this source for information on all foreign bank subsidiaries operating in the U.S. from 1978 to 2006.

Following prior empirical studies (e.g., DeYoung and Nolle, 1996; Miller and Parkhe, 2002; Miller and Eden, 2006), we focus on foreign banking subsidiaries operating in the U.S. Although foreign banks have the option to open other kinds of banking operations in the U.S (e.g., agencies, representative offices), those alternative operations are much narrower in scope and offer services that are unlike those offered by U.S. commercial banks. Foreign bank subsidiaries are afforded the same rights, and are subject to the same level of regulation, as are U.S. commercial banks (Goldberg and Saunders, 1981; Sponge, 1990; Miller and Eden, 2006). They are therefore similar in many respects to their domestic counterparts and can be fruitfully compared to domestic banking operations.

After removing observations for which data were not available (e.g., for some of the independent variables described below), we are left with a final sample of 80 foreign banks

with 170 subsidiaries from 25 distinct home countries. This results in an unbalanced panel of 1608 subsidiary-year observations, or about 10 yearly observations, on average, per subsidiary. Table 1 details the composition of our sample.

Insert Table 1 about here

Dependent variable

Following prior studies in the banking industry, we adopt ROA (return on assets) as our measure of *Performance* (see Gilbert, 1984; Barnett, Greve, and Park, 1994; Deephouse, 1999; Miller and Eden, 2006). ROA is calculated as the net income of the focal banking subsidiary, divided by its total assets in each year. The data are drawn from the Call Reports.

Independent variables

The main independent variable of interest to test our baseline proposition is institutional distance. Institutional distance is defined as the extent of similarity/difference between two countries in terms of its institutional context (Kostova, 1996; Xu and Shenkar, 2001). Institutional context refers to a country's formal and informal institutions (North, 1991; Scott, 1995). Formal institutions are those that are explicit and enforceable—i.e., property rights, rules, and laws. To measure a country's formal institutions, we focus on its economic, political, and regulatory institutions (see Bae and Salomon, 2010; Berry *et al*., 2010). By contrast, informal institutions include a country's social norms, beliefs, values, traditions, and codes of conduct. Many scholars refer to these institutions, broadly, as cultural institutions (Jensen and Szulanski, 2004). We therefore focus on national culture as our main informal institutional dimension.

Cultural distance

Hofstede defined national culture as the 'collective mental program' that normalizes behavior in a society (Hofstede, 2001). It is measured along five dimensions: power distance, uncertainty avoidance, individualism/collectivism, masculinity/femininity, and long-term orientation (Hofstede, 2001). However, since the measure for long-term orientation was available for only a small subset of the countries in our sample, we measure the *Cultural*

Distance (CD) between the parent firm's home country and the U.S. using the other four dimensions, as per Kogut and Singh's (1988) widely adopted approach. Cultural distance is expressed as:

$$CD_i = \sum_{j=1}^{4}\left[\left(H_{ij} - H_{USj}\right)^2 / Var_j\right]/4,$$

where CD_i represents the cultural distance between country i and the U.S. H_{ij} captures cultural dimension j in country i and H_{USj} the cultural dimension j in the U.S. Var_j represents the variance on cultural dimension j across all countries.

Economic distance

Countries have heterogeneous economic structures and market orientations. Some countries are organized around private capital markets, while others feature banks that play a larger role in markets. The former is considered a 'capital market-oriented' structure, because firms generally rely on external capital markets to raise capital (Miller and Parkhe, 2002). The latter is known as a 'bank-oriented' market structure, because firms depend more on bank loans. In bank-oriented financial systems, banks and firms share longer-term relationships (Allen, 1993). In capital market-oriented financial systems, firms share transitory ties with a greater number of external stakeholders. Foreign banks may operate less efficiently when the home country's financial system differs markedly from that of the host country (Miller and Parkhe, 2002). Therefore, we compare financial market orientations across countries as a measure of economic distance.

We begin with a measure of market orientation in one country using the ratio of market capitalization (scaled by GDP) divided by bank credits to the private sector (scaled by GDP). These data are drawn from the World Bank World Development Indicators Database, a standard source of financial market orientation data used in the literature (Levine, 2002; Miller and Parkhe, 2002). We then compare the financial market orientation of one country to that of another. More specifically, we define *Economic Distance* (ED) as the absolute value of the difference between the foreign firm's home-country orientation and the U.S. orientation. A

greater value indicates a greater difference between the financial market of the home country and that of the U.S.

$$ED_{it} = \left| \left(\frac{Market\ Capitalization_{it} / GDP_{it}}{Bank\ Credit\ to\ \Pr ivate\ Sector_{it} / GDP_{it}} - \frac{Market\ Capitalization_{U.S.t} / GDP_{U.S.t}}{Bank\ Credit\ to\ \Pr ivate\ Sector_{U.S.t} / GDP_{U.S.t}} \right) \right|$$

Regulatory distance

Although scholars have long recognized regulation as an important component of the formal institutional environment (North, 1991; Scott, 1995), very few studies incorporate cross-country regulatory differences as a measure of institutional distance (see Perkins, 2008; Salomon and Wu, 2012). Regulations influence organizational behavior and normalize organizational activities (Scott, 1995), and they are especially important in this context (Miller and Parkhe, 2002; Miller and Eden, 2006). Therefore, differences in the home and host regulatory environments stand to impact the performance of foreign banks in the U.S.

To capture the impact of differing regulations on foreign banks, we create a regulatory distance measure using the Banking Regulation Database (Barth, Caprio, and Levine, 2001a; 2001b). Barth, Caprio, and Levine (2001a, 2001b) collect comprehensive data on banking regulations in 107 countries from surveys conducted at two periods; the first from 1998 to 2000 (Barth, Caprio, and Levine, 2000), and the second—which updates the first—from 2001 to 2003. For all periods from 1978 to 2000 we apply the 1998–2000 survey measures of regulatory distance. For the years 2001–2006 we use the 2001–2003 survey data.

Barth, Caprio, and Levine (2001a; 2001b) measure the following dimensions of banking regulation: Bank Activity Regulations, Banking/Commerce Mixing Regulations, Competition Regulations, Capital Regulations, Official Supervisory Actions, Official Supervisory Experience and Structure, Private Monitoring, Deposit Insurance Schemes, and Market Structure. We are not able to include all dimensions in our regulatory distance measure because some indicators of supervision and deposit insurance are not made public, and several dimensions had missing values that affect our sample size.

Accordingly, we use the Bank Activity Regulations, Banking/Commerce Mixing Regulations, Competition Regulations, and Capital Regulations dimensions to create our regulatory distance measure. We construct the *Regulatory Distance* (RD) variable as follows:

$$RD_i = \left[\sum_{j=1}^{4} (R_{ij} - R_{USj})^2 / Var_j \right] / 4,$$

where R_{ij} refers to the *j*th regulatory dimension in country *i*, R_{USj} captures to the *j*th regulatory dimension in the U.S., and Var_j is the variance on *j*th dimension across all countries. By construction, a greater value on this metric implies a greater regulatory distance between the home country and the U.S.

As Barth, Caprio and Levine (2000) point out, financial regulations have changed little during our sample period, even after serious banking crises. Thus, any bias inhered due to the exclusion of particular dimensions and/or the application of data retrospectively (i.e., applying the 1998–2000 survey measures to the 1978–2000 period) is likely to be small.

Political distance

To operationalize political distance—i.e., the difference in political institutions across countries—we use the CHECKS index drawn from the Database of Political Institutions (Beck, Clarke, Groff, Keefer, and Walsh, 2001; Keefer and Stasavage, 2003). The CHECKS index captures the number of veto players in a political system, adjusting for political cohesiveness. A greater number of veto players means more political checks and balances are in place, and policies are less likely to change arbitrarily. This results in the political environment being more predictable (Beck *et al.* 2001; Keefer and Stasavage, 2003).

Firms become accustomed to, and learn how to operate effectively under, the political system in their home market. When they enter politically distant countries, conducting business becomes more difficult (e.g., Gaur and Lu, 2007). We therefore measure *Political Distance* (PD) as the absolute value of the difference in political volatility (the CHECKS index) between the firm's home country and the U.S. A greater value indicates greater difference between the political environment of the home country and that of the U.S.

$$PD_{it} = \left| CHECKS_{it} - CHECKS_{USt} \right|$$

Isomorphism strategy

The main independent variable used to test Hypotheses 1 and 2 is isomorphism strategy. Following prior studies (e.g., Miller and Eden, 2006), we constructed this variable by comparing the asset strategy of a foreign banking subsidiary with that of U.S. commercial banks in the same local market (Metropolitan Statistical Authority).

Asset strategy refers to a bank's asset portfolio—i.e., how a bank allocates its assets across various products such as commercial loans, residential loans, and securities (e.g., Haveman, 1993; Deephouse, 1999). Although government regulators (via the Federal Reserve Board, Federal Deposit Insurance Corporation, and the Comptroller of the Currency) supervise the operations of banks in the United States and pay particular attention to the security of a bank's financial capital and assets (Sponge, 2000), U.S. banking regulations have no particular requirements for the allocation of bank assets to particular asset classes. That is, as long as banks can meet their regulatory capital requirements, they have substantial latitude in determining their asset mix (Deephouse, 1999). Therefore, a bank's asset portfolio reflects its operational strategy (e.g., Haveman 1993; Mehra, 1996; Deephouse 1999).

As mentioned above, we compare the asset strategy of the focal foreign banking subsidiary to domestic banks operating in the same Metropolitan Statistical Authority (MSA). Although firms could conceivably imitate competitors operating in other markets, they tend to focus on local competitors (Baum, Li, and Usher, 2000; Chang and Park, 2005). As one might expect, banks operating in close geographic proximity generally face similar environmental conditions (Miller and Eden, 2006); and accordingly, the practices of local domestic banks serve as a valuable point of reference for the focal bank.

We therefore follow precedent by delineating market boundaries by MSA (Barnett, Greve, and Park, 1994; Berger, 1995; Deephouse, 1999; Miller and Eden, 2006). A MSA comprises a densely populated urban area and its adjacent counties (U.S. Census Bureau,

2010), a definition that is more specific than for a State, which emphasizes administrative boundaries. MSAs generally have closer sociological and economic ties than States. In addition to sharing close sociological and economic ties, MSAs are often the focus of bank regulators (Barnett, Greve, and Park, 1994).

Given these considerations, we measure the focal subsidiary's local isomorphism strategy as the similarity between its asset portfolio and that of its U.S. counterparts in the same MSA in any given year. Following Miller and Eden (2006), we compare banks based on their asset strategy—i.e., the proportion of the total assets they allocate to each of eight asset classes: commercial loans, real estate loans, loans to individuals, other loans and leases, cash, overnight money, securities, and fixed assets.

Formally, for each foreign banking subsidiary i at time t, we calculate its asset strategy A_{nit} (n=1…8) as a proportion of subsidiary i's total assets at time t. We then calculate the mean of this asset strategy across all U.S. banks in the same MSA: labeled A_{ntUS}. We compare A_{nit} with this mean, and then divide it by the standard deviation of the asset strategy of U.S. banks in the MSA. We multiply this difference by -1 for ease of interpretability (Finkelstein and Hambrick, 1990; Miller and Eden, 2006).

$$IS_{it} = \left\{ \sum_{n=1}^{8} ABS\left[\left(A_{nit} - M\left(A_{ntUS} \right) \right) / SD\left(A_{ntUS} \right) \right] \right\} * \left(-1 \right)$$

This measure captures how a foreign bank subsidiary's asset strategy deviates from the local average. It reflects a foreign banking subsidiary's overall *Isomorphism Strategy* (*IS*) at time t. A larger value of *IS* reflects greater levels of local isomorphism—i.e., the bank more closely resembles domestic banks in the local market in a given year—while a smaller value for *IS* reflects lower levels of local isomorphism.

Host-country experience

Hypothesis 2 examines the how host-country experience affects the relationship between isomorphism and performance. We measure *Host-Country Experience* as the cumulative number of banking institute-years of operation in the U.S. for the parent bank at time t

(Salomon and Wu, 2012). The measure is time-varying in that it captures not only the total number of banking institutes opened by the focal parent bank in the U.S., but also the total number of years for which it has operated its various banking institutes. Moreover, it accounts for any local experience accumulated prior, and subsequent, to the opening its first full-fledged U.S. subsidiary.

Control variables

In addition to the measures described above, we control for several variables at the levels of subsidiary, firm, and country that stand to influence foreign bank performance.

First, we control for the performance of the focal subsidiary at time *t-1* (lagged *Performance*). Including the lagged dependent variable controls for omitted variable bias and any persistence in performance (Kennedy, 1998). This also captures any distributed-time effects (Fomby, Hill and Johnson, 1984).

Second, we include host-country experience, given that prior literature demonstrates a connection between experience and performance (Miller and Eden, 2006; Sampson, 2006).

Third, we control for the efficiency of bank subsidiaries. As Deephouse (1999) suggests, asset strategy does not account for a bank's cost efficiency, as more cost-efficient banks may perform better than others. Therefore, we follow Deephouse (1999) and Miller and Eden (2006) to control for cost efficiency using the bank's expense ratio. *Expense Ratio* is defined as the ratio of total expenses to total assets in a given year.

Fourth, we acknowledge that competition can influence performance. Carroll and Hannan (1989) illustrate that competition intensifies as local density grows, and Miller and Eden (2006) found that the number of local domestic banks is negatively associated with foreign bank performance. We therefore control for the *Number of Local Rivals*—the cumulative number of commercial banks operating in the local market in a given year. Similarly, to account for the relative attractiveness of particular locations, we control for the average performance of local U.S. banks in a given year. We define *Local U.S. Rival Performance* as the average ROA of all U.S. banks in the same MSA in a given year.

Fifth, we control for the parent bank's size, strategy, and international experience. We control for the size of the parent bank in its home country (*Total Assets,* expressed in millions of U.S. dollars) to account for any systematic relationship between resources and performance. Insofar as the parent bank's strategy is concerned, foreign subsidiaries may simply replicate their parent bank's strategy. To avoid erroneously ascribing such an outcome to isomorphism (see Salomon and Wu, 2012), we construct a firm-specific Herfindahl index, which captures the parent bank's asset allocation in the home country at time *t*. We label this measure *Parent Bank Strategy*. Moreover, we control for the parent bank's international experience in other countries in order account for any influence of international experience on performance in the U.S. As Delios and Henisz (2003) point out, multinational firms can leverage their international experience across countries to reduce the costs and risks of operating in unfamiliar markets. We therefore define *Prior international experience* as the cumulative number of host countries in which the parent bank has banking operations at time *t*.

Sixth, we control for country-level factors that can impact the expected performance of foreign subsidiaries in the host market. Specifically, we define *FDI Flow* as the sum of inward and outward foreign direct investment between the U.S. and the focal bank's home country in a given year. Scholars argue that banks often expand to foreign markets to serve existing customers (Aliber, 1984; White, 1982; Qian and Delios, 2008). Increasing cross-border investment between the U.S. and the focal home country brings potentially greater demand-side opportunities for the focal foreign bank. We therefore expect *FDI Flow* (expressed in millions of U.S. dollars) to correlate positively to the performance of local bank subsidiaries. Data on inward and outward FDI were drawn from the Bureau of Economic Analysis.

Finally, prior studies have suggested that in addition to institutional distance, geographic distance is negatively correlated with foreign subsidiary performance (e.g., Zaheer, 1995; Ghemawat, 2001), because the cost of managing and coordinating far-flung subsidiaries increases in geographic distance. Therefore, we include a measure of *Geographic Distance* (in millions of kilometers) between the capital of the home country and the U.S.

Statistical method

Baseline model: Institutional distance and foreign bank performance.

To test our baseline expectation, we examine the unconditional relationship between institutional distance and the performance of the foreign bank subsidiary. Specifically, we regress ROA on the measures of institutional distance, plus controls. However, because our sample is an unbalanced panel with multiple observations per bank subsidiary, the error terms might not be independent across same-bank observations over time. A fixed- or random-effects approach may address such serial correlation (Kennedy, 1998; Greene, 2002); however, the fixed-effects model is less suitable for our purposes, because our model includes time-invariant measures such as cultural distance. Additionally, there are various countries that have only one bank subsidiary. For this reason we employ the random-effects model to generate unbiased generalized least squares (GLS) estimates. We add year dummies to control for any time-dependent trends in bank performance. The unconditional GLS estimation procedure is expressed in equation (1):

$$ROA_{it} = \alpha_0 + DS_{it}\beta_0 + X_{it}\beta_1 + \gamma_i + F_t + e_{it} \tag{1},$$

where ROA_{it} reflects the performance of foreign bank subsidiary i at year t; DS_{it} is a vector of institutional distance measures; X_{it} is a vector of firm- and environment- specific control variables; γ_i is the systematic bank subsidiary effect; F_t are the individual year dummies; and, e_{it} is the error term, assumed to be random across independent observations.

H1: Accounting for isomorphism

As we mention in the theory leading up to Hypothesis 1, it could be that foreign entrants anticipate the impact of distance on performance and make their strategy decisions accordingly. If each bank selects a strategy based on its individual characteristics and the environmental conditions, the firm's isomorphism strategy choice could mediate the distance-performance relationship. More importantly, an isomorphism strategy meant to ameliorate the impact of distance would reflect the outcome of an endogenous process (Shaver, 1998; Sirmon and Hitt, 2009). In other words, the model presented in equation (1) does not take into account the

conditional impact of strategy selection on the relationship between distance and performance, and might therefore generate biased results.

To account for the impact of strategy selection (in this case, isomorphism) on the relationship between institutional distance and performance, we specify a system of equations using an instrumental variable approach. Specifically, we adopt a two-stage least squares (2SLS) instrumental variable model. In the first stage, we estimate a strategy selection equation, where we identify the endogenous variable (isomorphism strategy) as a function of a set of independent variables plus a set of instrumental variables (Greene, 2002; Hsiao, 2003). Equation (2) formally expresses our first-stage estimation procedure,

$$IS_{it} = \alpha_1 + DS_{it}\beta_2 + X_{it}\beta_3 + IV_{it}\beta_4 + \varepsilon_{it} \qquad (2).$$

In equation (2), IS_{it} reflects the level of local isomorphism adopted by focal foreign bank subsidiary i at time t; DS_{it} is a vector of institutional distance measures; X_{it} captures the control variables; IV_{it} are the instrumental variables; and ε_{it} is the error term.

In instrumental variable models such as the one we estimate in equation 2, the instruments are used to identify the system of equations. Adequate instruments should meet two criteria: They should correlate with the dependent variable in the first stage, but not correlate with the second-stage dependent variable (Greene, 2002; Hsiao, 2003).

Given this, we selected two instrumental variables. The first is *Foreign Bank Market Share*, measured using the ratio of deposits of foreign bank subsidiaries to total deposits in the MSA (excluding the focal banking subsidiary). This measure meets both criteria laid out above—there is a strong correlation between *Foreign Bank Market Share* and *Isomorphism Strategy* (r = 0.22) and a low correlation between *Foreign Bank Market Share* and *Performance* (r = 0.002).

Our second instrument is a measure of the variance among asset strategies U.S. banks pursue in the same MSA as the focal bank. This measure, *U.S. Bank Strategy Variance*, reflects the sum of the standard deviations among U.S. banks across all eight asset categories. This measure is, by construction, correlated with the isomorphism dependent variable, but it is not endogenous to the focal bank. The focal subsidiary does not get to choose the asset allocation

strategies of other banks in its MSA. Moreover, the sum of standard deviations of domestic banks does not have a strong influence on the focal bank's performance. Indeed, *U.S. Bank Strategy Variance* is significantly correlated with *Isomorphism Strategy* (r = 0.12), and yet not significantly correlated with *ROA* (r = 0.006).

Once we regress the isomorphism dependent variable (IS_{it}) on all variables (including instruments) as in equation (2), we generate fitted values that replace the isomorphism variables in the second stage model. The second stage now represents a variant of equation (1), but conditional on strategy selection. Expressed formally:

$$ROA_{it} = \alpha_2 + DS_{it}\beta_5 + X_{it}\beta_6 + \widehat{IS}_{it}\beta_7 + \gamma_i + F_t + \eta_{it} \tag{3},$$

where $\widehat{IS}_{it}$ represents the predicted isomorphism strategy adopted by focal bank subsidiary *i* in year *t*, and η_{it} is an error term that is uncorrelated with the independent variables—and especially isomorphism. All remaining variables are as in equation (1).

This approach provides two benefits for our purposes. First, it allows us to test H1 in a way that accounts for endogeneity. That is, we are able to speak to the effect of isomorphism on firm performance in a way that accounts for the fact that isomorphism is not a randomly assigned treatment variable; rather, we account for the possibility that firms choose their level of isomorphism. Second, it allows a cleaner interpretation of the institutional distance affect. That is, to the extent that firms are able to mitigate the liability of foreignness via isomorphism, the impact of institutional distance should disappear. Should distance impact firms beyond isomorphism, the effect will persist.

H2: Experience as a moderator

To test hypothesis 2, we employ a variant of the instrumental variable approach described in equations (2) and (3). Statistics scholars point out that the appropriate way to handle interactions in instrumental variable models is to create an additional equation with the interaction of interest treated as endogenous (Kenny and Judd, 1984). Therefore, we add an additional instrument to the system of equations, consisting of an interaction between the moderator and the original

instruments (Kenny and Judd, 1984; Bollen and Paxton, 1998). Such an approach faithfully captures the influence of the moderator on the first-stage endogenous variable. We therefore modify our system of equations from (2) and (3) as follows:

$$IS_{it} = \alpha_3 + DS_{it}\beta_8 + X_{it}\beta_9 + IV_{it}\beta_{10} + (IV_{it}*EXP_{it})\beta_{11} + \xi_{it} \tag{4};$$

$$(IS_{it}*EXP_{it}) = \alpha_4 + DS_{it}\beta_{12} + X_{it}\beta_{13} + IV_{it}\beta_{14} + (IV_{it}*EXP_{it})\beta_{15} + \varsigma_{it} \tag{5};$$

$$ROA_{it} = \alpha_5 + DS_{it}\beta_{16} + X_{it}\beta_{17} + \widehat{IS}_{it}\beta_{18} + (\widehat{IS}_{it}*\widehat{EXP}_{it})\beta_{19} + \gamma_i + F_t + \zeta_{it} \tag{6}.$$

Equation (6) is our model of interest, where *Performance* (ROA_{it}) is regressed on the predicted isomorphism strategy ($\widehat{IS}_{it}$) and its predicted interaction with host-country experience ($\widehat{IS}_{it}*\widehat{EXP}_{it}$).

RESULTS

Table 2 presents descriptive statistics and product moment correlations. Although correlations are generally as expected, some correlations, such as that between host country experience and FDI flow, are high, hinting at a potential multicollinearity concern. Influence tests, however, did not suggest multicollinearity. The maximum VIF score was 4.22 and the mean was 2.47—well below suggested thresholds (Belsley, Kuh, and Welsch, 1980).

Insert Table 2 about here

Table 3 presents the multivariate regression results meant to test the baseline proposition. Column 1 consists of the base model of control variables. As expected, the positive and significant coefficient for lagged ROA (*Performance$_{(t-1)}$*) suggests a time trend in foreign bank subsidiary performance. Past performance positively correlates to current performance. Likewise, the average performance of local U.S. banks positively impacts the performance of foreign bank subsidiaries. Local market characteristics that influence the performance of U.S. banks also influence the performance of foreign banks. Similarly, the more the subsidiary emulates its parent's strategy (*Parent Bank Strategy*), the better the subsidiary performs.

Insert Table 3 about here

Columns 2 through 5 introduce the institutional distance variables of interest meant to test the unconditional baseline liability of foreignness proposition. The coefficient for cultural distance from column 2 suggests that, as the cultural distance between the home country of the foreign bank and the U.S. increases, performance decreases. Similarly, as indicated in column 3, the relationship between economic distance and performance is negative and significant. Regulatory distance (from column 4) is also negatively related to bank performance, as foreign banks from more regulatorily distant countries bear additional costs that manifest in decreased performance. In contrast with the findings related to regulatory, economic, and cultural distance, the results from column 5 show that political distance effects do not differ from zero. Column 6 includes all independent variables. The direction and significance of coefficients are similar to those in columns 1–5. The results generally support our baseline proposition, and they suggest that foreign banking subsidiaries from institutionally similar countries face a lower liability of foreignness and perform better in the U.S.

Insert Table 4 about here

Table 4 presents the results of our two-stage model meant to test Hypothesis 1. Specifically, we account for strategy selection—i.e., isomorphism as a means to mitigate the liability of foreignness. Column 1 reports the results of the first-stage estimation. We note that cultural, economic, and regulatory distances are all positively correlated with isomorphism. Consistent with extant theory (see Salomon and Wu, 2012), this suggests that foreign firms from institutionally distant countries are more likely to imitate the strategies of local domestic firms. The question remains, however, as to whether isomorphism helps.

Column 2 reports the results of the second-stage performance model. Although the institutional distance variables (culture, economics, and regulation) are similar in direction to those in Table 3, economic distance is not significantly related to performance, as shown in Table 3. Moreover, the effect of isomorphism, though directionally consistent, does not meaningfully differ from zero. Taken together, the effects of distance, coupled with those of isomorphism, suggest that institutional distance has an effect on firm performance independent of firm strategy,

and that choosing a strategy of local isomorphism does not buffer firms from the deleterious impact of distance. As such, Hypothesis 1 fails to receive support.

Insert Table 5 about here

We turn to the moderating impact of experience in Table 5, the results of which test Hypothesis 2—that experience moderates the link between isomorphism and performance. Specifically, we hypothesized that, as firms accumulate experience, isomorphism would become a less-important tool to mitigate the liability of foreignness. Columns 1 and 2 summarize the results of the first-stage models. Column 3 contains results for the performance equation of interest.

The results in column 3 are somewhat different than those presented in column 2 of Table 4. Although we find an insignificant effect of isomorphism in Table 4, once we account for experience, the coefficient on the isomorphism variable becomes positive and significant. Entrants from institutionally distant countries that choose a strategy of local isomorphism at the outset perform better than they would have had they not selected such a strategy. This provides conditional support for Hypothesis 1. Meanwhile, the interaction between isomorphism and host country experience is negatively related to foreign bank performance. This supports Hypothesis 2. Taken together therefore, the results suggest that isomorphism provides performance benefits when the foreign entrant has limited experience in the host country. However, as the focal firm acquires local experience, imitation does not provide the same value it does at the outset.

To further investigate whether bank experience masked the isomorphism effects in Table 4, we ran a set of ad hoc results including only the first subsidiaries opened in the U.S. by each foreign bank. We removed all subsidiaries opened after the first from the sample to analyze results on a subsample of first bank entries. These results appear in Table 6.

Insert Table 6 about here

The results in Table 6 mirror those from column 2 in Table 4, with one notable difference—the sample size is significantly smaller. We do not present the first-stage results in Table 6, because they are similar to those in Table 4. Interestingly, once we eliminate each

bank's later subsidiary entries, we find that isomorphism is, indeed, positively related to performance. This corroborates our findings from Table 5, and again, lends support to Hypothesis 1. For initial entries, subsidiaries from distant countries are better off choosing a strategy of local isomorphism. Moreover, that strategy buffers them, to a certain extent, from the negative impact of distance on performance. However, as was the case in Tables 4 and 5, the impact of distance is not completely eliminated; elements of distance impact performance even when firms choose a strategy with distance in mind.

Sensitivity and robustness

To assess the sensitivity and robustness of our findings, we tested variants of the results presented herein.[2]

First, although we treat institutional distance as a multi-dimensional construct comprised of distinct factors, the individual institutional factors share common variance. We therefore re-ran our results collapsing the individual cultural, political, economic, and regulatory factors into one overarching distance measure using the Mahalanobis (1936) approach as described by Berry *et al*. (2010). Consistent with the findings presented herein, we found the Mahalanobis institutional distance to be negatively related to performance and positively related to isomorphism. The remaining results from Tables 4 and 5 did not change.

Second, we acknowledge that Japanese, Canadian, and U.K. subsidiaries collectively account for nearly 59% of the sample subsidiary observations. To insure that observations from these countries did not drive our findings, we re-ran results alternatively excluding Japanese, Canadian, and U.K. observations. The results were consistent with those presented herein.

DISCUSSION AND CONCLUSION

Organizational scholars suggest that firms often imitate the strategies of others, and especially in situations characterized by uncertainty and information asymmetry (e.g., DiMaggio and Powell, 1983; Haunschild, 1993; Henisz and Delios, 2001). Foreign entrants,

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[2] All models discussed in the sectoin are available from the authors upon request.

as outsiders in the host country, face both uncertainty and information asymmetry. The extent of uncertainty and information asymmetry that foreign entrants face varies in institutional distance; hence, foreign entrants have a greater incentive to imitate local firms when they hail from distant markets (Salomon and Wu, 2012). By imitating the practices of local firms, foreign entrants adopt practices that better fit the local institutional environment, acquire legitimacy, and potentially offset disadvantages associated with being foreign.

To verify whether imitative strategies of local isomorphism translate into performance benefits for firms from distant countries as theory suggests, this study examined a set of related questions. First, do foreign entrants from institutionally distant countries adopt isomorphic strategies, and do those adopted strategies improve performance? Second, to the extent that isomorphism positively impacts the performance of subsidiaries from institutionally distant countries, does isomorphism mitigate the liability of foreignness? Finally, how does experience influence the relationship between distance, isomorphism, and subsidiary performance?

To test these relationships, we use an instrumental variable approach explicitly treating isomorphism as endogenous. We examine the hypothesized effects using a sample of 80 foreign banks with 170 foreign bank subsidiaries operating in the U.S. from 1978 to 2006.

First, we establish that institutional (cultural, regulatory, and economic) distance is negatively associated with foreign subsidiary performance as a baseline. We further demonstrate that firms account for institutional distance when selecting a strategy. Foreign entrants from institutionally distant countries opt for greater levels of local isomorphism. With respect to performance, isomorphism does not completely eliminate the impact of distance. Distance negatively impacts subsidiary performance even when firms select their strategies based on the expected impact of distance. This suggests that irrespective of the strategy pursued, entrants bear some liability of foreignness.

Insofar as the link between isomorphism and performance is concerned, the relationship is more nuanced. Specifically, isomorphism strategies have a positive impact on

performance for entrants from institutionally distant countries at the outset. However, over time, and with experience, the same level of benefit does not accrue to foreign firms. The findings suggest that foreign entrants would be better served to abandon isomorphic strategies as they gain experience in the local market.

Taken together, the findings from this study stand to make several contributions to the extant strategy, international business, and organizational literatures. First, following Shaver (1998), we explicitly treat isomorphism as an endogenous strategic decision adopted by foreign firms, which recognizes that firm strategy varies by context. For our purposes, the findings demonstrate that firms choose a level of local isomorphism that is commensurate with the institutional distance constraints they face.

Second, to our knowledge, this is the first study that explicitly links distance, isomorphism, and performance. By adopting this approach, we can more accurately isolate the impact of institutional distance on isomorphism, and subsequently, the impact of isomorphism on performance. More generally, this method informs the circumstances under which isomorphism strategies work for different firms.

Finally, our findings highlight how dynamics are important in strategic decision-making—that the "optimality" of a given strategy can change with time and/or experience. Specifically, our findings demonstrate that the benefits of isomorphism decrease in firm experience. Evidence suggests that, although isomorphism is a strategic asset for firms from institutionally distant countries at the outset, it becomes a strategic liability as the focal firm acquires experience in the local market.

Managers should heed this latter finding when they are making commitments to particular entry strategies, given that strategies that provide value at the outset may not continue to offer value over time. Managers would be wise to pay close attention to the boundary conditions influencing the impact of imitative strategies on performance and adjust their initial strategies as they gain experience in the local market. They should remain

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especially vigilant not to let organizational inertia take hold, so as to bear the negative performance consequences of what was once an optimal strategy.

We openly acknowledge several limitations of the study. First, we realize that foreign firms have a variety of strategies available to them when entering foreign markets, and here we focus only on one: the choice to pursue a strategy of local isomorphism. With respect to our liability of foreignness findings, there may be other entry strategies that help firms mitigate the costs born out of institutional distance. For example, firms might ally with knowledgeable partners, choose alternative entry modes, and/or build ties with agents in the host country prior to entry as a means to mitigate liability of foreignness risks. We would certainly encourage future research to examine alternative pre- and post-entry strategies for handling the liability of foreignness, and we believe our instrumental variable approach can be useful for future studies that link distance, strategy, and performance.

Second, we recognize the inherent weakness in our measure of local isomorphism. Although we adopt this measure because extant research deems it an important strategic variable for banks, foreign banks can certainly imitate other business practices of domestic competitors such as the bank location, loan-granting policies, etc. We humbly acknowledge our inability to examine aspects of banking operations other than asset allocation strategy. Moreover, we measure isomorphism by comparing the asset portfolio of the focal foreign bank to the average asset portfolio of domestic banks in the same MSA. Although this approach has been adopted in many prior studies, the average asset portfolio may not represent the majority of domestic banks. We certainly hope that future research identifies additional measures of isomorphism to complement those used up to this point.

Ultimately, we encourage further research into the interplay among distance, isomorphism, and performance so that we may draw stronger conclusions. However, the limitations notwithstanding, this study provides insight into a novel and complex strategic phenomenon. We hope others will improve upon our contribution by pushing this research in new and interesting directions.

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Table 1: Sample composition

	Home Country	Number of Banks	Number of Subsidiaries	Number of Observations
1.	Australia	1	1	6
2.	Brazil	1	1	8
3.	Canada	5	46	517
4.	Colombia	1	1	15
5.	Denmark	1	1	11
6.	France	1	4	39
7.	Germany	1	3	9
8.	Greece	2	2	36
9.	India	1	1	22
10.	Ireland	2	11	50
11.	Israel	4	4	43
12.	Italy	3	3	26
13.	Japan	23	31	368
14.	Korea	8	8	94
15.	Mexico	1	1	17
16.	Netherlands	2	12	98
17.	Philippines	3	4	32
18.	Portugal	1	1	2
19.	Slovenia	1	1	8
20.	Spain	5	5	50
21.	Switzerland	1	1	4
22.	Taiwan	3	3	22
23.	United Kingdom	7	23	113
24.	Venezuela	1	1	16
25.	Yugoslavia	1	1	2
	Total	80	170	1608

	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16
1. Performance$_{(t)}$	1.00															
2. Performance$_{(t-1)}$	0.14	1.00														
3. Expense ratio$_{(t)}$	0.01	-0.05	1.00													
4. Host-country experience$_{(t)}$	0.05	0.02	-0.08	1.00												
5. Local competitors$_{(t)}$	0.02	-0.01	0.01	0.21	1.00											
6. U.S. bank performance$_{(t)}$	0.29	0.03	-0.03	0.20	0.12	1.00										
7. Parent bank assets$_{(t)}$	-0.01	-0.00	-0.00	-0.04	0.00	0.00	1.00									
8. Parent bank strategy$_{(t)}$	0.08	0.04	0.01	0.03	0.10	0.03	-0.02	1.00								
9. Parent Int'l experience$_{(t)}$	0.03	-0.00	0.00	0.12	-0.03	0.03	-0.03	0.12	1.00							
10. FDI flow$_{(t)}$	0.06	0.02	-0.04	0.70	0.08	0.19	-0.05	0.16	0.25	1.00						
11. Geographic distance	-0.05	-0.01	0.03	-0.59	-0.40	-0.19	-0.02	-0.23	0.08	-0.43	1.00					
12. Cultural distance	-0.09	-0.05	0.02	-0.52	-0.24	-0.20	0.01	-0.33	-0.04	-0.53	0.79	1.00				
13. Economic distance$_{(t)}$	-0.03	-0.00	0.01	-0.19	-0.23	-0.06	0.02	0.13	0.08	-0.08	0.15	-0.01	1.00			
14. Regulatory distance$_{(t)}$	0.01	-0.01	-0.01	0.10	0.02	0.11	-0.04	0.26	0.48	0.24	-0.37	-0.50	0.27	1.00		
15. Political distance$_{(t)}$	-0.02	-0.04	0.03	-0.29	-0.12	-0.11	0.04	-0.12	-0.04	-0.23	0.30	0.29	0.01	-0.16	1.00	
16. Isomorphism strategy$_{(t)}$	-0.05	-0.09	-0.00	0.10	0.18	0.05	-0.05	0.01	0.04	0.01	-0.04	0.02	-0.01	0.02	-0.04	1.00
Mean	0.01	0.01	0.08	179.27	171.59	0.01	0.56	0.37	13.84	135.74	5.97	1.48	0.29	1.53	1.16	-7.09
Standard deviation	0.03	0.03	0.22	180.37	107.06	0.01	7.05	0.11	13.37	118.20	4.40	1.30	0.49	1.16	1.25	5.78
Minimum	-0.26	-0.26	0.00	0.00	1.00	-0.04	0.00	0.00	0.00	0.00	0.61	0.08	0.00	0.25	0.00	-141.42
Maximum	0.71	0.71	5.67	681.00	458.00	0.14	180.00	0.84	75.00	667.32	15.96	4.37	11.60	7.71	13.00	-1.02

Table 3: Regression results – baseline expectations

DV=Performance$_{(t)}$	1	2	3	4	5	6
Constant	-0.008*	-0.004	-0.009**	-0.004	-0.008*	0.002
	(-1.48)	(-0.88)	(-1.65)	(-0.52)	(-1.53)	(0.28)
Performance$_{(t-1)}$	0.137***	0.134***	0.133***	0.136***	0.137***	0.127***
	(5.32)	(5.19)	(5.17)	(5.28)	(5.33)	(4.91)
Expense ratio$_{(t)}$	0.003	0.003	0.003	0.003	0.003	0.003
	(0.97)	(0.97)	(0.96)	(0.91)	(0.96)	(0.91)
Host-country experience$_{(t)}$	0.000	0.000	0.000	-0.000	0.000	-0.000
	(0.36)	(0.31)	(0.26)	(-0.30)	(0.37)	(-0.59)
Number of local rivals$_{(t)}$	-0.000	-0.000	-0.001*	-0.001*	-0.000	-0.001
	(-1.09)	(-0.98)	(-1.35)	(-1.37)	(-1.03)	(-1.18)
U.S. bank performance$_{(t)}$	0.692***	0.686***	0.696***	0.703***	0.694***	0.696***
	(11.52)	(11.38)	(11.59)	(11.67)	(11.53)	(11.54)
Parent bank assets$_{(t)}$	-0.002	-0.002	-0.003	-0.004	-0.003	-0.003
	(-0.23)	(-0.17)	(-0.24)	(-0.37)	(-0.27)	(-0.32)
Parent bank strategy$_{(t)}$	0.017**	0.014**	0.021***	0.019***	0.017**	0.017**
	(2.26)	(1.82)	(2.67)	(2.45)	(2.29)	(2.13)
Parent int'l experience$_{(t)}$	0.004	0.003	0.006	0.013**	0.004	0.016**
	(0.61)	(0.57)	(0.94)	(1.84)	(0.63)	(2.02)
FDI flow$_{(t)}$	-0.000	-0.006	0.001	0.001	-0.000	-0.007
	(-0.03)	(-0.55)	(0.15)	(0.08)	(-0.04)	(-0.70)
Geographic distance	0.012	0.360	0.046	-0.306	-0.005	0.315
	(0.05)	(1.09)	(0.19)	(-1.06)	(-0.02)	(0.88)
Cultural distance		-0.002**				-0.003***
		(-1.65)				(-2.75)
Economic distance$_{(t)}$			-0.006**			-0.005*
			(-2.05)			(-1.48)
Regulatory distance$_{(t)}$				-0.002**		-0.002**
				(-2.08)		(-2.02)
Political distance$_{(t)}$					0.000	0.000
					(0.52)	(0.46)
Bank effects	YES	YES	YES	YES	YES	YES
Time effects	YES	YES	YES	YES	YES	YES
N	1608	1608	1608	1608	1608	1608
ΔWald chi-square$_{(d.f.)}$	--	3.09*$_{(1)}$	4.58**$_{(1)}$	4.76**$_{(1)}$	0.19$_{(1)}$	14.68***$_{(4)}$

Note: p-values: * p < .1; ** p < .05; *** p < .01 (one-tailed tests)
    t-statistics are in parentheses

Table 4: Regression results – isomorphism strategy and performance

First-stage model:	DV = Isomorphism$_{(t)}$	Second-stage model:	DV= Performance$_{(t)}$
Constant	-20.096*** (-15.93)	Constant	0.004 (0.44)
Performance$_{(t-1)}$	-14.964*** (-3.35)	Performance$_{(t-1)}$	0.110*** (4.02)
Expense ratio$_{(t)}$	-0.167 (-0.28)	Expense ratio$_{(t)}$	0.004 (1.01)
Host-country experience$_{(t)}$	0.039*** (4.97)	Host-country experience$_{(t)}$	-0.000 (-0.96)
Number of local rivals$_{(t)}$	0.009*** (5.11)	Number of local rivals$_{(t)}$	-0.000 (-0.19)
U.S. bank performance$_{(t)}$	4.522 (0.42)	U.S. bank performance$_{(t)}$	0.695*** (11.35)
Parent bank assets$_{(t)}$	-9.320 (-0.49)	Parent bank assets$_{(t)}$	-0.0310 (-0.28)
Parent bank strategy$_{(t)}$	2.547** (1.77)	Parent bank strategy$_{(t)}$	0.018** (2.08)
Parent int'l experience$_{(t)}$	2.111 (1.21)	Parent int'l experience$_{(t)}$	0.017** (1.66)
FDI flow$_{(t)}$	-9.750*** (-5.27)	FDI flow$_{(t)}$	-0.003 (-0.28)
Geographic distance	11.160* (1.53)	Geographic distance	0.110 (0.26)
Cultural distance	0.637*** (2.59)	Cultural distance	-0.003** (-1.99)
Economic distance$_{(t)}$	0.420* (1.36)	Economic distance$_{(t)}$	-0.001 (-0.60)
Regulatory distance$_{(t)}$	0.597*** (3.03)	Regulatory distance$_{(t)}$	-0.002** (-2.05)
Political distance$_{(t)}$	-0.126 (-1.11)	Political distance$_{(t)}$	0.000 (0.42)
Instrument: Strategic variation$_{(t)}$	9.122*** (9.03)	**Isomorphism strategy$_{(t)}$**	**0.0002** **(0.42)**
Instrument: Foreign bank market share$_{(t)}$	7.597*** (3.92)		
Bank effects	YES	Bank effects	YES
Year effects	YES	Year effects	YES
N	1608	N	1608
Wald chi-square$_{(d.f.)}$	214***$_{(16)}$	Wald chi-square$_{(d.f)}$	185.31***$_{(15)}$

Table 5: Regression results – the moderating effect of host-country experience

First-stage model:	DV=Isomorphism$_{(t)}$	Isomorphism*Exp$_{(t)}$	Second-stage model:	Performance$_{(t)}$
Constant	-25.871***	-1081.699***	Constant	0.013*
	(-15.09)	(-4.14)		(1.35)
Performance$_{(t-1)}$	-16.254***	-2445.892***	Performance$_{(t-1)}$	0.119***
	(-3.59)	(-3.55)		(4.09)
Expense ratio$_{(t)}$	0.060	17.106	Expense ratio$_{(t)}$	0.003
	(0.10)	(0.18)		(0.93)
Host-country experience$_{(t)}$	0.037***	-8.020***	Host-country experience$_{(t)}$	-0.0001***
	(6.41)	(-9.19)		(-2.34)
Number of local rivals$_{(t)}$	0.009***	0.889***	Number of local rivals$_{(t)}$	-0.001
	(4.98)	(3.34)		(-1.22)
U.S. bank performance$_{(t)}$	21.559**	7622.014***	U.S. bank performance$_{(t)}$	0.781***
	(1.95)	(4.53)		(9.97)
Parent bank assets$_{(t)}$	-15.800	-396.000	Parent bank assets$_{(t)}$	-0.011
	(-0.82)	(-0.14)		(-0.10)
Parent bank strategy$_{(t)}$	2.203*	361.056**	Parent bank strategy$_{(t)}$	0.018**
	(1.56)	(1.68)		(2.04)
Parent int'l experience$_{(t)}$	0.164	-2.019	Parent int'l experience$_{(t)}$	0.010
	(1.00)	(-0.81)		(1.03)
FDI flow$_{(t)}$	-6.660***	-158.490***	FDI flow$_{(t)}$	-0.014
	(-3.34)	(-5.22)		(-1.01)
Geographic distance	2.080	868.060	Geographic distance	0.156
	(0.31)	(0.85)		(0.39)
Cultural distance	0.594***	26.447	Cultural distance	-0.004***
	(2.58)	(0.76)		(-2.52)
Economic distance$_{(t)}$	0.164	-4.989	Economic distance$_{(t)}$	-0.002
	(0.52)	(-0.10)		(-1.90)
Regulatory distance$_{(t)}$	0.650***	94.900***	Regulatory distance$_{(t)}$	-0.002**
	(3.38)	(3.24)		(-1.72)
Political distance$_{(t)}$	-0.164*	-12.396	Political distance$_{(t)}$	0.000
	(-1.40)	(-0.70)		(0.30)
Instrument: Strategic variation$_{(t)}$	16.566***	226.948	**Isomorphism strategy$_{(t)}$**	**0.002***
	(9.39)	(0.85)		**(2.82)**
Instrument: Foreign bank market share$_{(t)}$	15.676***	2277.222***	**Isomorphism strategy$_{(t)}$**	**-0.00001**
	(5.23)	(4.99)	***HC experience$_{(t)}$**	**(-2.24)**
Instrument: Strategic variation$_{(t)}$*experience$_{(t)}$	-0.041***	2.791***		
	(-5.39)	(2.42)		
Instrument: Foreign market share$_{(t)}$*experience$_{(t)}$	-0.035***	-0.759		
	(-3.84)	(-0.55)		
Bank effects	YES	YES	Bank effects	YES
Year effects	YES	YES	Year effects	YES
N	1608	1608	N	1608
Wald chi-square$_{(d.f.)}$	253***$_{(18)}$	2546***$_{(18)}$	Wald chi-square$_{(d.f)}$	186.47***$_{(16)}$

Table 6: Regression results – isomorphism and performance (first subsidiaries)

Second-stage model:	DV= Performance$_{(t)}$
Constant	0.017*
	(1.31)
Performance$_{(t-1)}$	0.113***
	(3.02)
Expense ratio$_{(t)}$	0.035***
	(3.27)
Host-country experience$_{(t)}$	0.000
	(0.33)
Number of local rivals$_{(t)}$	-0.002
	(-0.86)
U.S. bank performance$_{(t)}$	0.926***
	(7.66)
Parent bank assets$_{(t)}$	-0.035
	(-0.25)
Parent bank strategy$_{(t)}$	0.008
	(0.68)
Parent int'l experience$_{(t)}$	-0.001
	(-0.61)
FDI flow$_{(t)}$	0.022
	(1.08)
Geographic distance	0.005
	(0.01)
Cultural distance	-0.005***
	(-2.86)
Economic distance$_{(t)}$	-0.009**
	(-2.01)
Regulatory distance$_{(t)}$	-0.001
	(-0.76)
Political distance$_{(t)}$	0.001
	(0.97)
Isomorphism strategy$_{(t)}$	**0.001****
	(1.97)
Bank effects	YES
Year effects	YES
N	901
Wald chi-square$_{(d.f.)}$	106.84***$_{(15)}$