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Performance Outcome of Leadership Succession at Foreign Subsidiaries in Japan. Does Nationality Matter?

Abstract

Leadership succession has been an important topic for research and management practice because of its effect on firm performance. This study integrates leadership succession and expatriate staffing literatures by investigating performance outcomes of leadership succession at foreign subsidiaries in Japan. We distinguished four types of CEO successors: expatriate followers (expatriate succeeds another expatriate), localizers (local manager succeeds an expatriate), local followers (local manager succeeds another local manager), and ambassadors (expatriate succeeds a local manager). Our theory and evidence from 2,113 firm-year observations, including 521 successions, suggests that successor types have direct and moderating effects with contextual firm-level factors on subsidiary performance. We extend agency theory by showing that both local and foreign subsidiary CEOs pursue their own, unique interests affecting firm performance in different ways.

Keywords: CEO succession, expatriate staffing, foreign subsidiary performance, leader succession, Japan, succession consequences

INTRODUCTION

When Carlos Ghosn arrived in Japan in 1999, Nissan, the second largest Japanese automaker, was on the verge of bankruptcy. Even though shareholders, stakeholders, and the press were skeptical at the beginning, Ghosn was able to turn Nissan back into a profitable firm within a few years (Froese & Goeritz, 2007). This remarkable success made Ghosn one of the most admired foreign managers in Japan. Meanwhile, Michael Woodford became CEO of Olympus, a major Japanese camera maker, in October 2011. Within the same month, Woodford uncovered and made public a loss hiding scheme in Olympus' past, resulting in his own dismissal and Olympus' share loss of more than 75% of its value.

These two examples illustrate that newly appointed CEOs can have a strong influence on firm performance for good and for bad. In response, a large body of research has investigated how leadership succession affects firm performance (for reviews see Giambatista, Rowe, Riaz, 2005; Karaevli, 2007). Prior leadership succession studies have often focused on the effects of insiders, those from the same firm and/or industry, and outsider successors on firm performance (Giambatista et al., 2005; Karaevli, 2007). Findings are mixed and recent studies suggest that the effect depends on contextual variables such as pre-performance (Karaevli, 2007). Unfortunately, the majority of prior research was confined to large, stock-listed American and European firms or sports teams (Giambatista et al., 2005). The few studies conducted in other countries suggest that the antecedents and mechanisms of leadership succession performance might differ across countries (Sakano & Lewin, 1999). Thus, more research concerning different countries and types of organizations is needed (Giambatista et al., 2005). Further, despite the

growing importance of international business, no study – to our knowledge – has investigated performance consequences of leadership succession at foreign subsidiaries. A few studies investigated expatriate staffing at foreign subsidiaries (e.g. Colakoglu & Caliguiri, 2008; Gaur et al., 2007; Gong, 2003, O'Donnell, 2000), and found mixed results whether expatriate or local top managers have positive or negative effects on subsidiary performance. However, these studies were of cross-sectional nature and could thus not investigate the performance effects of leadership succession. This study investigates the consequences of leadership successions on the performance of foreign subsidiaries.

The present study intends to make the following contributions. First, this study integrates expatriate staffing and leadership succession literatures. By integrating these literatures, we hope to reconcile previously mixed findings in the leadership succession and expatriate staffing literatures. The foreign subsidiary context characterized by relatively small firms, part of an international firm network, and global staffing options, is an exciting context to improve our understanding of the consequences of leadership succession. Second, we develop a more refined understanding of agency theory, i.e. information asymmetry and conflicts of interest between owners and managers, in the context of foreign subsidiary management. While prior expatriate staffing research focused on agency dilemmas between headquarters and host country national (HCN) managers (e.g. Gong, 2003), we provide a more balanced view by investigating agency dilemmas of both HCN and expatriate managers. Third, following recent research and recommendations (e.g. Giambatista et al., 2005; Karaevly, 2007), we further investigate how contextual firm-level factors influence the relationship between leadership

succession and firm performance. More specifically, we investigate the interactive effects of subsidiary age and prior performance with succession types. Finally, we provide country-specific information about foreign subsidiaries in Japan, an important economy for multinational enterprises (MNE). Currently, there are more than 3,000 foreign subsidiaries present in Japan (Toyo Keizai, 2010).

The remainder of this study is organized as follows. The next section reviews relevant literature and develops the study's hypotheses. The third section describes the data and measures. The fourth section presents the results. The final section discusses the findings, explains limitations, and provides managerial recommendations.

THEORETICAL BACKGROUND

In line with prior leadership succession and expatriate research (e.g. Giambatista et al., 2005, Gong, 2003), our theoretical framework is based on agency theory and institutional theory. As prior research suggests that one single theory is hardly able to fully cover the complexities of leadership succession (Peng, 2004), particularly in an MNE context, we combine these two theories for an increased conceptual understanding.

Agency theory, referring to moral hazard and conflicts of interest between principals (owners) and agents (managers) (Jensen & Meckling, 1976), serves as a prominent theoretical explanation within the expatriate staffing and leadership succession literatures (Giambatista et al, 2005; Gong, 2003; O'Donnell, 2000). From this perspective, potential misalignment and conflicts arise between principals and agents causing economic costs. For instance, Zhang et al. (2008) found that information asymmetry led to a higher rate of dismissals of CEOs in US manufacturing firms. In expatriate research,

agency theory focuses on the reduction of economic incentive misalignment problems between the headquarters (as principals) and the foreign subsidiaries (as agents) (Brock et al. 2008; Yan et al. 2002; O'Donnel, 2000). Gong (2003) found that MNEs sought to reduce agency dilemmas between foreign subsidiaries and headquarters by staffing more expatriates in culturally more distant host countries; and that expatriates had a positive effect on subsidiary performance, but this effect declined the longer the MNE gained experience in the foreign country.

Another guiding theory in expatriate staffing and leadership succession literature is based on institutional theory (DiMaggio & Powell, 1983) covering social practices, cultural values and beliefs (North, 1990). North (1990) defines institutions as 'macro-level rules of the game' (p. 27) and organizations to seek legitimacy in the institutional environment (Dickson et al., 2004), what can be mapped with 'legally sanctioned behavior', 'morally governed behavior' and 'recognizable, taken-for-granted behavior' (Scott et al., 2000, p. 238) respectively. It is important to note that inter-organizational networks (e.g., between headquarters and top managers of subsidiaries) and competition are also driving forces behind an organization's input, output, as well as beliefs, norms and traditions (Dickson et al., 2004; Kimberly, 1981). Organizations are embedded within networks, which generate formal and informal pressures of headquarters strategic alignments and the need to localize activities of subsidiaries to conform to the pressure of a given market (Pfeffer, 1981). Institutional environments as measured by the Institutional Development Index (IDI) are reported to be negatively related to foreign affiliate performance (Chan et al. 2008). Gaur et al. (2007) found that foreign subsidiaries

with expatriate CEOs achieve higher performance in countries with higher institutional distance.

In the context of foreign subsidiaries, we propose herein that there are four distinct types of possible CEO[1] successions: expatriate followers, localizers, local followers, and ambassadors. Expatriate followers are expatriates who are sent by the headquarters to replace other expatriate subsidiary managers. This succession type is common particular among young subsidiaries that are still in the process of establishment when control and coordination are important (Harzing, 2001). Localizers refer to HCN managers who succeed expatriate top managers. We termed this type of succession localizers because it indicates a strategic change in regard to localizing the top management position. Local followers refer to HCN managers who succeed other HCN managers. Ambassadors are those expatriates who succeed HCN managers and thus reverse the localization of staffing.

Prior leadership succession research often distinguished between inside (same industry and/or firm) and outside successions. Outside successors were found to initiate more strategic change than inside followers (Giambatista et al, 2005); however, the effects on firm performance have been mixed (Karaevli, 2007). Shen and Cannella (2002) further increased our understanding by distinguishing inside successors into followers, those appointed after regular retirement of their predecessors, and contenders, those appointed after CEOs were dismissed. We applied the concept of inside and outside successors to the foreign subsidiary context. We created a two-by-two matrix to comprehend inside and outside status of successors (see Table 1). On the vertical axis, we

[1] We use the term CEO and refer by this to the top managerial position within the foreign subsidiary. Depending on the firm, other terms such as general manager, managing director, country head, and president, are sometimes used to describe the same position.

depicted expatriate and HCN managers, and on the horizontal axis we depicted headquarters and global linkages versus foreign subsidiary and local stakeholders. In this classification, expatriate and HCN managers are both insiders and outsiders at the same time depending on the relevant constituencies. HCN managers are usually insiders within the foreign subsidiaries in their home country and well connected with local stakeholders, e.g. employees, while being outsiders from the headquarters perspective. In contrast, expatriate managers might be insiders from the headquarters' perspective, and better able to communicate and coordinate with the headquarters (Harzing, 2001), while being an outsider from the foreign subsidiary perspective. Given that localizers and ambassadors indicate a change in staffing of the foreign subsidiary, we would expect more changes associated with these two types of successors in contrast to the other two successor types.

(Insert Table 1 around here)

This complex and challenging situation is likely to create various impacts of leadership succession on foreign subsidiary performance. We expected each leadership succession type to have a direct and moderating influence with firm-contextual factors on subsidiary performance. We focused on prior performance and subsidiary age as firm-contextual factors because these two factors were found to be particular relevant in leadership succession and expatriate staffing literature, respectively (Gong, 2003; Karaevli, 2007; Sekiguchi et al., 2011). Based on agency theory, institutional theory and the insider-outside debate we propose the following conceptual framework (see Figure 1). In the following, we develop our hypotheses in more detail.

(Insert Figure 1 around here)

Hypotheses development

In line with agency theory extensions in the expatriate staffing context (Brock et al., 2008; Yan et al., 2002; O'Donnel, 2000Gong, 2003), we would expect HCN subsidiary CEOs to be less able to coordinate with and absorb knowledge from the headquarters and international network of the MNE. Since transfer of knowledge from headquarters and internal flows of goods and investments to the foreign subsidiary are important to reduce cost and increase sales of the foreign subsidiary, HCN successors, localizers and local followers alike, are expected to be associated with lower performance.

If MNEs appoint localizers to head the foreign subsidiary this signals a change in strategy. Employees of the foreign subsidiary might have increased expectations and more demands toward localizers, e.g. demand for better working conditions. Localizers in turn might feel more obliged to local stakeholders, e.g. employees and local suppliers, than to the headquarters in a foreign country. These pressures might lead to misalignment problems between the localizer and the headquarters (Gong, 2003), and lower subsidiary performance eventually. We argue for institutional inertia and expect negative performance consequences if MNEs continue the same staffing strategy by appointing a local follower. From an agency perspective, we would expect that each continuous local follower successor will weaken the link with the headquarters and thus result in lower subsidiary performance. Based on our theoretical arguments, we develop the following hypotheses:

Hypothesis 1a: Localizer successors will be negatively associated with foreign subsidiary performance.

Hypothesis 1b: Local follower successors will be negatively associated with foreign subsidiary performance.

Prior expatriate staffing studies argued that multinational enterprises often send expatriates to overseas subsidiaries for control and coordination purposes because they are familiar with the culture and management practices of the headquarters (O'Donnell, 2000; Yan et al., 2002; Gong, 2003, Harzing, 2001). Under the traditional understanding of agency theory extensions in the MNE context (Brock et al., 2008; Gong, 2003), we would assume to have higher performance after the succession of an expatriate CEO either by replacing another expatriate CEO (expatriate followers) or a local CEO (ambassadors). However, we argue that also expatriate managers are associated with agency dilemmas for two reasons.

First, expatriate managers might have short-term orientations and thus avoid any major risks and investments because their term at the foreign subsidiary is usually limited to three to five years. Imagine an American expatriate would be dispatched for three years to the Japanese subsidiary. During the first 12 to 18 months the expatriate needs to adjust to the foreign environment and during the last six to 12 months the expatriate needs to prepare the return to the headquarters. Thus, such an expatriate manager can only devote six to 12 months fully to managing the subsidiary. Under these circumstances,

it is understandable that expatriate CEOs prefer to avoid any major and long-term decisions because they only bear the risks but are unlikely to reap the long-term benefits.

Second, rooted in institutional distance, expatriate CEOs may face liabilities of foreignness (Zaheer, 1994), i.e. lack of local knowledge and acceptance. Even if expatriate CEOs intend to implement major strategic decisions, they might not be able to do so due to their lack of local knowledge and outsider status in the foreign subsidiary. Due to vast cultural differences, Japan might be a particular difficult place for Western expatriates (Froese & Peltokorpi, 2011). HCN employees further might not be willing to support expatriate managers (Toh & Denisi, 2007). Senior HCN managers might resent foreign follower successors because they would have desired the same position but were neglected in promotion decisions by the headquarters. HCN employees might be particular unwilling to support ambassadors because this signals a reverse of localization. Due to these and general challenges of adapting to a new culture, expatriates often perform below expectations and may terminate their contracts early (Bhaskar-Shrinivas et al., 2005). Overall, we argue that the disadvantages of being an outsider at the foreign subsidiary are stronger than the advantages of being mentally closer to the headquarters in determining foreign subsidiary performance. This leads to the following hypotheses:

Hypothesis 1c: Expatriate follower successors will be negatively associated with foreign subsidiary performance.

Hypothesis 1d: Ambassador successors will be negatively associated with foreign subsidiary performance.

Leadership succession literature argues that it is not only the succession event itself but the contextual factors that affect post succession firm performance (Finkelstein & Hambrick, 1996; Karaevli, 2007). Therefore, in addition to the direct effects of leadership succession types, we investigate how relevant firm-level contextual factors influence foreign subsidiary performance. Based on prior leadership succession literature (Graffin, et al., 2011; Giambatista et al, 2005; Karaevli, 2007) and expatriate staffing literature (Gaur et al., 2007; Gong, 2003; Sekiguchi et al., 2011) we focus on the moderating effects of prior performance and foreign subsidiary age.

If prior foreign subsidiary performance was low, we would expect – in line with agency theory - that ambassador successors would serve as 'firefighters' and re-align the struggling foreign subsidiaries closer to the headquarters. Expatriate CEOs can reduce misalignment problems between the headquarters and the subsidiary especially in case the subsidiary was unsuccessful in the past with the need for implementing strategic changes. Agency theory arguments would argue that an ambassador would be outperforming any other type of successor in this situation. The arguments lead us to the following hypothesis:

Hypothesis 2a: If the prior foreign subsidiary performance was low ambassador successors will be associated with higher performance.

In contrast, based on of our enriched understanding of expatriate agency dilemmas as explained earlier, we argue that a foreign successor, both ambassadors and expatriate followers, would further deteriorate performance of low performing

subsidiaries. Reasoning for this is that foreign followers would avoid risk taking and tend to delay important decisions to their successors. Ambassador successors might further face difficulties to overcome HCN employees' resistance when trying to implement necessary change to revamp struggling subsidiaries. HCN employees might resent the reverse localization of staffing and are unwilling to cooperate with the new foreign subsidiary CEO. In conclusion, expatriate followers might not want to and ambassadors might not be able to implement any necessary restructuring to turn the ailing subsidiary back to profits. This line of logic leads to the following competing hypotheses (compared to hypothesis 2a):

Hypothesis 2b: If the prior foreign subsidiary performance was low expatriate follower successors will be associated with lower performance.

Hypothesis 2c: If the prior foreign subsidiary performance was low ambassador successors will be associated with lower performance.

Our second moderator variable is the age of the subsidiary. Based on cross-sectional data, Sekiguchi et al. (2011) found that subsidiary performance was higher at younger subsidiaries when managed by an expatriate managing director. In a similar vein, Gong (2003) found that the positive effect of expatriate managers on subsidiary performance diminished over time. The other way around, their findings suggest that later localization of staffing is related with better performance. Accordingly, we would expect that localizer successor would be related with higher performance if the subsidiary is older. This would be in line with agency reasoning and the findings of Gong (2003) that

it is preferable to rely on local managers after the subsidiary is established. From an institutional theory perspective, foreign MNEs are gaining legitimacy by localizing their CEO staffing. Gaining legitimacy, in turn, would result in higher subsidiary performance. Given these arguments, we suggest the following hypothesis:

> **Hypothesis 3**: A localizer successor will be associated with higher foreign subsidiary performance if the subsidiary is older.

After having proposed two-way interaction effects for subsidiary age and prior performance with succession types, respectively, we propose some tentative three-way interaction effects combining all our main variables. In our three way interactions, we turn our focus to two of our succession types: ambassadors and foreign followers and investigate their interactive effects with prior performance and subsidiary age on post-succession performance.

According to our enriched understanding of expatriate agency dilemmas, we would expect that ambassador and expatriate follower successions would result in lower performance in older and low performing foreign subsidiaries. That would be reasoned by difficulties for expatriate managers to implement changes in older and established firms. The older the subsidiaries the more established are organizational routines and management practices. Thus, expatriates should face more difficulties to change older and more established subsidiaries. Further, they are outsiders both to the foreign subsidiary employees and to the foreign culture and usually stay only for a limited period of time. Thus, HCN employees might not see the need to accept painful change initiatives,

particularly in older and established subsidiaries. Instead, HCN employees may prefer to sit out and delay efforts by foreign managers (Froese & Goeritz, 2007). Agency arguments would also state that foreign followers would be less inclined to initiate change at older firms to avoid potential conflicts. If however, expatriate managers implement drastic changes without the support of HCN employees this might result in disruptive change. Older firms are more likely to suffer from disruptive change resulting in higher organizational failure (Amburgey, Kelly, Barnett, 1993). These arguments lead to the following hypotheses:

Hypothesis 4a: Ambassador successors will be negatively associated with foreign subsidiary performance if the subsidiary is older and low performing.

Hypothesis 4b: Foreign follower successors will be negatively associated with foreign subsidiary performance if the subsidiary is older and low performing.

METHODS

Sample

This study analyzed data from Toyo Keizai Gaishikei Kigyo Soran (database on foreign affiliated firms in Japan compiled by Toyo Keizai). We included data from 1999 to 2010. However, due to the need for performance data three years before and after the succession (Giambatista et al., 2005, Karaevli, 2007), we limited our analysis to successions from 2002 to 2007. Even though the data base covers around 3,000 firms per year, only around 400 firms provided sufficient financial data for each year. In order to increase our sample, we included all subsidiaries that provided sufficient data three years

before and after the succession resulting in an unbalanced panel data set. Overall, our sample includes 554 subsidiaries and 2,113 firm-year observations, including 521 successions. Among those 554 subsidiaries, 328 (59%) subsidiaries experienced successions, and 138 (25%) subsidiaries experienced even more than one succession within our six year time frame. The breakdown of the different succession types is depicted in Table 2.

(Insert Table 2 around here)

The most common industries are manufacturing (38%), finance and insurance (30.1%), wholesale and trade (17.6%), and information and communication (5.5%). Most foreign subsidiaries have their headquarters in the U.S. (47.6%), Germany (10.7%), United Kingdom (9.4%), Switzerland (5.6%), France (5.4%), the Netherlands (3.0%), and South Korea (2.7%). The size of the subsidiaries in terms of employees range from 2 to 33,601 with a mean of 835.4 and standard deviation of 2,639.2 and have been in Japan for three to 121 years (mean = 29.1, SD = 19.4).

Measures

In line with prior research (Chan et al., 2008, 2011), we measured subsidiary performance as return on sales (ROS = Net profit / sales). Due to the lack of data and complex accounting practices within the subsidiary networks of multinational enterprises, such sales related efficiency measures are superior to shareholder value and return on assets data (Chan et al., 2008, 2011). Since ROS can vary greatly across industries, we

used industry-adjusted z-scores for all performance indicators, a common procedure in recent leadership succession research (Karaevli, 2007). To reduce the influence of short-term fluctuations and as recommended by prior research (e.g. Giambatista et al., 2005, Karaevli, 2007), we used three-year averages before and after the succession to measure pre- and post succession performance. Pre-succession ROS was used as a control variable and moderating variable and post-succession ROS was our dependent variable.

As explained above, we are interested in how the four different types of leadership succession affect subsidiary performance. Two bilingual graduate students coded the origin of subsidiary CEOs at T0 and T1 for each year from 2002 to 2007, distinguishing between Japanese and non-Japanese (=foreign) CEOs. This was easy because all the names of foreign CEOs, unlike those of Japanese CEOs, are listed in katakana and roman letters in the database. In addition, we paid particular attention to foreign CEOs from countries/regions where they also use kanji (Chinese) characters, i.e. China, Taiwan, South Korea, and Singapore, but found the same way of data organization. Due to the way the data was provided our assistants reached 100% agreement on the origin of the CEOs. To further validate and better understand the origin of CEOs we conducted online research on about 100 successors. This additional step revealed that all CEOs classified as Japanese were Japanese and that all CEOs classified as non-Japanese were non-Japanese. Our additional results further revealed that several foreign CEOs were recruited from other foreign subsidiaries of the same MNE, e.g. German CEO of the Indonesian subsidiary was appointed CEO of the Japanese subsidiary. We compared CEO origin in T0 and T1 and computed four dummy variables for each leadership succession type and used ‘no succession’ as the reference category.

Based on prior research (Giambatista et al., 2005; Gaur, 2007; Gong, 2003; Karaevli, 2007), we included several control variables that might have an influence on post-succession subsidiary performance. We controlled for industry using the Japan Statistics Bureau 20 cluster classifications. Potential home country effects, e.g. cultural and institutional differences, currencies, were considered in our estimations by creating dummies for major countries/regions represented in our data: the US, Eurozone, Asia, UK, Switzerland. In additional tests, we also entered cultural distance (Kogut & Singh, 1988), as a control variable but the results remained essentially the same. For firm level effects, we controlled for subsidiary age (years), subsidiary size as measured by the number of employees (natural logarithm of number of employees), and invested capital (natural logarithm of invested capital in Japanese Yen), foreign ownership (percentage of foreign ownership), prior performance (pre-ROS) as explained above.

RESULTS

Correlations, means, and standard deviations of our main variables of interest are depicted in Table 3. Post foreign subsidiary performance was positively correlated with prior performance ($r = 0.27$) suggesting that performance was somewhat carried over. Expatriate followers, localizers, and ambassadors were negatively correlated with foreign subsidiary performance.

(Insert Table 3 around here)

We conducted random effects generalized least squares (GLS) regressions to test our hypotheses because we are dealing with panel data and an unbalanced sample of around 400 firms per year. Since the variances of observations are unequal (heteroscedasticity) and there is a certain degree of correlation between the observations, GLS is superior to ordinary least squares, and thus the preferable choice (Hamilton, 2009). We conducted several hierarchical GLS regressions to better understand our data. First, we only entered the control variables. Second, we added the main effects, i.e. four succession types. Third, we added the two-way interaction terms of succession types with prior performance. For a comprehensive understanding, we entered all possible interaction terms in our analysis of interaction terms. Fourth, instead of prior performance, we entered the interaction term of succession type with subsidiary age. Finally, we entered all direct, two-way-, and the three-way interaction terms of succession types with firm age and prior performance.

(Insert Table 4 around here)

Results of our analyses are depicted in Table 4. Our baseline model only including the control variables (Model 1), could only explain 4% of the variance of post performance. When we entered the four succession types (Model 2), the model could explain 6% of the variance. In line with hypotheses 1a and 1c, expatriate followers (beta = -0.0111, $p < 0.01$) and localizers (beta = -0.0166, $p < 0.001$) were negatively associated with foreign subsidiary performance supporting our both hypotheses accordingly. However, hypotheses 1b and 1d found no support because neither local follower nor

ambassador successors were associated with foreign subsidiary performance. From a different perspective, we can conclude that any successor, no matter HCN or expatriate manager, succeeding an expatriate CEO was associated with lower post-performance. In contrast, if the predecessor was Japanese, successors, regardless of their origin, did not have a statistically significant impact on post-performance. This seems to partly support our argument of short-term oriented expatriate managers who delay important decisions and investments and leave those jobs to be done by their successors.

When we added the interaction terms of succession types with prior performance (Model 3), the model had a statistically better fit than model 2 (ΔWald $\chi 2$ (4) = 170.48, $p < 0.001$), suggesting that the moderating effects were relevant. Expatriate follower (beta = 0.0266, $p < 0.001$) and ambassador successors (beta = 0.0279, $p < 0.1$) interacted with prior performance in predicting post-performance, implying that these successors accentuated the effect of prior performance. If prior performance was high, expatriate followers and ambassadors could further increase post performance; however, more critical to our interest of investigation, if prior performance was low these successors further deteriorated foreign subsidiary performance. Thus, these finding support hypothesis 2b and 2c but reject the competing hypothesis 2a. We further note, that local followers could reduce the negative impact on prior performance on post performance (beta = -0.0862, $p < 0.001$).

In model 4, when we added the interaction terms of succession types with subsidiary age, the model had a statistically better fit than model 2 (ΔWald $\chi 2$ (4) = 14.71, $p < 0.05$), suggesting that the moderating effects were relevant. As expected in hypothesis 2, localizers interacted positively with subsidiary age in predicting foreign subsidiary

performance. This suggests that localizers perform more successfully at older, more established subsidiaries.

Finally, we entered all interaction terms in a complete model (Model 5). This model outperformed a model that only included direct, and all two-way interaction terms (not shown here due to space limitations, ΔWald $\chi 2$ (4) = 22.70, $p < 0.001$). Providing support for hypothesis 4a, the three-way interaction term of ambassador successors with prior performance and subsidiary age was statistically significant (beta = 0.0068, $p < 0.01$), implying that ambassadors were associated with lower post performance in older and low performing foreign subsidiaries. In contrast, local followers (beta = -0.0055, $p < 0.05$) and localizers (beta = -0.0101, $p < 0.05$) could reduce the negative effect of prior performance in older subsidiaries.

DISCUSSION

This study attempted to investigate performance consequences of leadership succession at foreign subsidiaries in Japan. Based on an integrated overview of expatriate staffing and leadership succession literatures (e.g. Giambatista et al., 2005; Gaur, 2007; Gong, 2003; Karaevli, 2007), we developed and tested a framework based on agency theory, institutional theory, and insider-outsider debate how different types of successors influence subsidiary performance. Considering the specific context of foreign subsidiaries, we distinguished between four different successor types: expatriate followers, localizers, local followers and ambassadors. Our results suggest that succession types directly and through interactive terms with contextual firm factors influence foreign subsidiary performance.

Theoretical implications

Our investigation provided several intriguing findings that increase our theoretical understandings. First, we extended agency theory in the foreign subsidiary context by theorizing and showing that not only local subsidiary managers might have diverging interests (Gong, 2003) but also expatriate managers, who might have their own agendas that are not necessarily in line with the interests of the headquarters. Findings showed that any successor to an expatriate CEO, i.e. expatriate followers and localizers, would be associated with lower foreign subsidiary performance as measured in ROS. This suggests that expatriate predecessors might have a short-term orientation. They might have streamlined efficiency by reducing cost through withholding investments into R&D and training, and avoided any costly and risky decisions partly because of their short tenure which is usually limited to three to five years. This behavior is understandable because expatriates would usually only bear the risk but not benefit from any long-term benefits.

Second, the interactive effects of prior-performance with expatriate followers and ambassadors on ROS seem to provide additional support for our argument of the short-term orientation of expatriate CEOs. Expatriate followers and ambassadors accentuated the effect of prior performance. If prior performance was high they could further improve performance, e.g. through cutting cost. However, both expatriate followers and ambassadors further deteriorated performance in low performing foreign subsidiaries. This suggests that in addition to a short-term orientation, new incoming expatriate CEOs may not find support and legitimacy among HCN stakeholders due to their outsider status (Toh & Denisi, 2007), to implement necessary change initiatives.

Third, the performance of ambassadors who might be sent to re-align struggling subsidiaries is particular disappointing because they tend to even cause further decline of foreign subsidiary performance, particular in older, more established ones. Perhaps, ambassadors face more resistance than foreign followers because HCN employees resent the reverse localization. In contrast, local followers and localizers were associated with higher performance in older and low performing subsidiaries further suggesting that insider status in the foreign subsidiary and country is more important than connections with the headquarters. Even though Woodford managed Olympus, a Japanese MNE based in Tokyo, his lamenting about his dismissal parallels our arguments and might be applicable to ambassadors at foreign subsidiaries in Japan as well: "I'm not superman. I can't change opinion in Japan in such a profound way. That has to come from within." (interview with Financial Times, 6 January 2012) "I understand why Japan gets tagged with the 'unique' label; it is one of the most impenetrable cultures for outsiders." (interview with British Chamber of Commerce in late 2011).

Finally, even though the direct effect of localizers on post performance was negative, the interactive effect of subsidiary age and localizer successors was positive, implying that localizers increased performance if the foreign subsidiary was older and more established. This finding is in line with agency theory extensions in the expatriate staffing context (Gong, 2003) and institutional theory, suggesting that legitimacy, i.e. localization of top management, is beneficial for foreign subsidiary performance when implemented at a later stage.

Managerial recommendations

The findings of this study provide several important recommendations for MNEs when making global staffing decisions for their foreign subsidiaries. First, due to the detrimental effect of expatriate CEOs on foreign subsidiary performance, MNEs should try to localize staffing in foreign subsidiaries. However, MNEs should not act hastily but wait until they have established the foreign subsidiary before appointing a HCN as subsidiary CEO.

Second, if MNEs need to appoint expatriate CEOs due to shortage of local talent or coordination and control objectives (Harzing, 2001) MNEs could provide incentives and organizational support to prevent short-term oriented behavior. In addition, if possible, MNEs should extent the duration of expatriate assignments. To reduce resistance of HCN employees towards expatriate managers' decisions, MNEs may provide (intercultural) training and incentives to HCN employees.

Third, if performance of the foreign subsidiary was low, MNEs may consider appointing HCN CEOs, particularly in established subsidiaries, because they are more likely to improve the subsidiary performance.

Fourth, MNEs may implement long-term global talent strategies to reduce the outside status of expatriate vis-à-vis foreign subsidiaries and countries and outside status of HCN vis-à-vis the headquarters. For instance, MNEs could dispatch expatriate managers at younger age and lower hierarchical level for development purposes to the foreign subsidiary and have them continuously engaged in projects with the same foreign subsidiary. Such managers would become experts for certain target countries and potential CEOs of those subsidiaries in the future. The other approach would be to

dispatch HCN managers to the headquarters and train them to internalize the headquarters' culture and practices.

Limitations and avenues for future research

The limitations of this study can serve as avenues for future research. First, this study only investigated leadership succession at foreign subsidiaries in Japan and is thus to a certain degree context bound. Even though we would assume that similar mechanisms would also operate in different countries, some of the observed effects could be stronger or weaker in other countries. For instance, Japan is argued to be culturally very different from Western countries. Gong (2003) and Gaur et al. (2007) found that cultural distance can affect subsidiary performance. Thus, the effect of leadership succession on performance could be weaker if cultural distance between headquarters and foreign subsidiaries is lower. Therefore, future studies should test our conceptual model in other countries.

Second, we only analyzed archival data, as it is common practice in expatriate staffing and leadership succession studies (e.g. Gaur et al., 2007; Gong, 2003, Karaevli, 2007, Sekiguchi et al., 2011). Future studies could conduct survey research to better understand the motivations and orientations of foreign subsidiary managers. When doing survey research, future studies might want to also investigate the role of leader characteristics such as individual values, and cross-cultural adjustment of expatriates (Takeuchi, 2010) in predicting foreign subsidiary performance. Furthermore, it would be interesting to investigate the perceptions of HCN employees as they can play important roles in the success of expatriate managers (Toh & Denisi, 2007).

Third, we only investigated six years of leadership succession. Our longitudinal approach is superior to cross-sectional analysis of prior expatriate staffing research. However, even longer time spans would enable to further investigate the evolutionary character of subsidiary development and its interactive effect with leadership succession types on firm performance. Despite these limitations, this study provided intriguing insights and extended our theoretical understanding of leadership succession at foreign subsidiaries.

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Tables and Figures:

Figure 1: Conceptual model

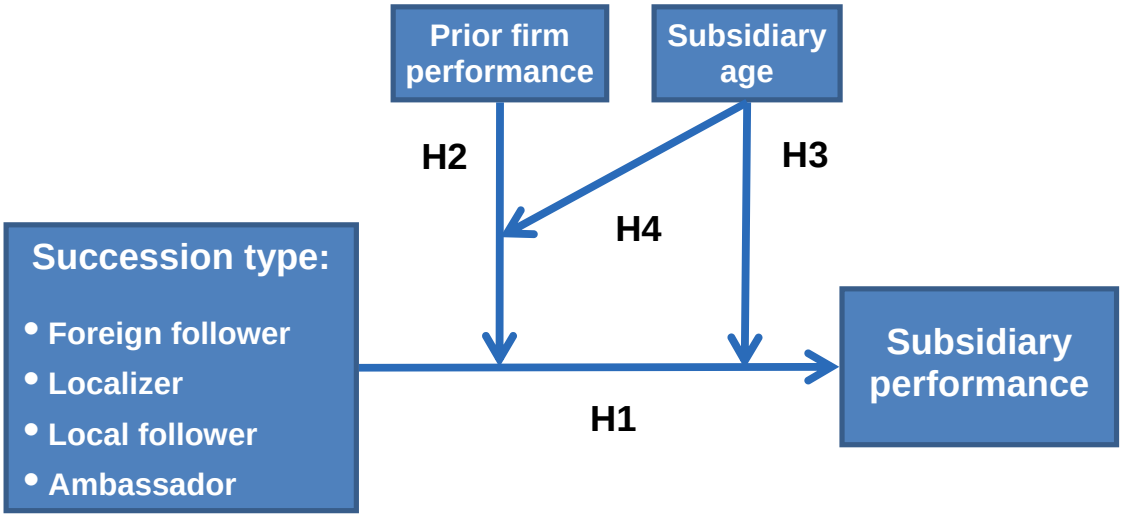

Table 1: Status of local versus expatriate successors

CEO origin	Orientation	
	HQ / Global	Subsidiary / Local
Local	Outsider	Insider
Expatriate	Insider	Outsider

Table 2: Distribution of different succession types

	Frequency	Percent
No succession	1,592	75.3
Expatriate follower	142	6.7
Localizer	51	2.4
Local follower	261	12.4
Ambassador	67	3.2
Total	2,113	100.0

Table 3: Correlation table

	Mean	SD	1	2	3	4	5	6	7	8	9
1 Adj. post ROS	0.00	0.15	1								
2 Adj. prior ROS	0.01	0.30	0.2725*	1							
3 Subsidiary age	29.12	19.43	-0.0047	0.0283	1						
4 LN invested capital	7.44	2.17	-0.0464*	0.0167	0.2061*	1					
5 LN employees	4.96	1.84	-0.036	0.1037*	0.3697*	0.4625*	1				
6 Foreign share	76.84	27.21	0.0401	0.0225	-0.1648*	0.1356*	-0.2322*	1			
7 Expatriate follower	0.07	0.25	-0.0484*	-0.0073	0.0018	0.1741*	-0.0318	0.1441*	1		
8 Localizer	0.02	0.15	-0.1153*	-0.0276	-0.0011	0.0610*	0.0541*	0.0774*	-0.0422	1	
9 Local follower	0.12	0.33	0.0291	0.0045	-0.004	-0.0405	0.0078	-0.1128*	-0.1008*	-0.0590*	1
10 Ambassador	0.03	0.18	-0.0451*	-0.0176	0.0045	0.0435*	0.0544*	0.0349	-0.0486*	-0.0285	-0.0679*

Note: * $p < 0.05$

Table 4: Results of GLS regressions with ROS as dependent variable.

	Model 1			Model 2			Model 3			Model 4			Model 5		
	Coef.	SE		Coef.	SE		Coef.	SE		Coef.	SE		Coef.	SE	
Adj. prior ROS	0.0402	0.0109	***	0.0443	0.0109	***	0.0388	0.0121	***	0.0466	0.0109	***	0.0434	0.0121	***
Subsidiary age	0.0003	0.0003		0.0003	0.0003		0.0001	0.0003		0.0002	0.0003		0.0001	0.0003	
LN Invested capital	0.0008	0.0037		0.0015	0.0036		0.0019	0.0034		0.0019	0.0036		0.0020	0.0033	
LN employees	-0.0070	0.0041	+	-0.0066	0.0040		-0.0065	0.0038	+	-0.0066	0.0039	+	-0.0063	0.0037	+
Foreign share	0.0003	0.0002		0.0004	0.0002	+	0.0004	0.0002	+	0.0004	0.0002	+	0.0004	0.0002	+
Expat follower (ExpF)				-0.0327	0.0111	**	-0.0220	0.0108	*	-0.0332	0.0112	**	-0.0232	0.0109	*
Localizer (Loc)				-0.0580	0.0166	***	-0.0632	0.0162	***	-0.0603	0.0167	***	-0.0630	0.0163	***
Local follower (LocF)				0.0073	0.0080		0.0082	0.0078		0.0074	0.0080		0.0100	0.0078	
Ambassador (Amb)				-0.0175	0.0144		-0.0184	0.0141		-0.0173	0.0145		-0.0099	0.0144	
ExpF X prior ROS							0.3104	0.0266	***				0.3025	0.0275	***
Loc X prior ROS							-0.0337	0.0362					-0.0453	0.0365	
LocF X prrior ROS							-0.0862	0.0255	***				-0.1313	0.0308	***
Amb X prior ROS							0.0481	0.0279	+				-0.0470	0.0429	
ExpF X age										0.0001	0.0005		-0.0001	0.0005	
Loc X age										0.0027	0.0008	***	0.0027	0.0008	***
LocF X age										-0.0005	0.0004		-0.0003	0.0004	
Amb X age										-0.0002	0.0007		-0.0005	0.0007	
ExpF X age X ROS													0.0016	0.0011	
Loc X age X ROS													-0.0101	0.0042	*
LocF X age X ROS													-0.0055	0.0022	*
Amb X age X ROS													0.0068	0.0023	**
Wald Chi square	27.31	*		51.34	***		221.82	***		66.05	***		263.5	***	
Degree of freedom	16			20			24			24			32		
Adjusted R-Square	0.0401			0.0617			0.1421			0.0707			0.1451		

Note: Industry and country dummies were included in the analyses but not depicted here due to space limitations.
+ $p < 0.1$, * $p < 0.05$, ** $p < 0.01$, *** $p < 0.001$