

Article Review

History Matters: Colonial-Based Connectivity and Foreign Headquarter Location Choice

Jackson Kent

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Introduction

The aim of this study is to explore the impact of former colonial relationships on foreign headquarter investments in Europe. The authors argue that historical and economic-based institutional connections play a crucial role in the location choices of foreign headquarters for countries with ties to their previous colonizers. Using a sample of 2230 foreign headquarter investments, the authors find that the stronger the combined effect of historical connections and current economic relationships with former colonies, the higher the probability of attracting headquarter investment projects. The authors aim to contribute to the literature by investigating the role that former colonies play in making foreign direct investment (FDI) more attractive for their past colonizers, advancing the understanding of foreign headquarter location choices and emphasizing the importance of historical context in international business research. The findings suggest that past colonial relationships and historical context influence FDI decisions and location preferences, but fail to be substantiated by adequate theoretical reasoning and methods using the provided empirical evidence.

Critical review

Aim, research question, and hypothesis

While it is interesting to consider what factors from post-colonial countries influence decisions to locate headquarters in past-colonizer European countries, it is difficult to accept “colonial-based connectivity” as a relevant variable to gauge this relationship, at least as the authors define the term. I argue that the combination of the two variables chosen, being whether

the given country was a past colony and the current economic relationship between that country and its past colonizer, are an inappropriate interaction to answer the question as to how FDI location strategies are influenced by historical colonial connections. Just using the colonial dummy would make sense to answer the question, but the authors do not give a good reason as to why interacting it with current economic relationships provides a more accurate depiction of the implications of having a colonial past. One solution would be to just look at whether the country was a past colony or not, and to include the current economic relationship as a separate variable to disentangle the two effects. This solution would add clarity to the specific aim of the study.

Theory used

There is a lack of adequate theoretical background in the author's justification of how they form their concept of "colonial-based connectivity." They argue that this connectivity is based on historical ties, providing evidence largely from North (1990)'s Institutional Theory. However, relevant theory regarding the inclusion of current economic relations is lacking. The authors claim that evidence from Castellani et al. 2021 yields a credible argument for including "economic bilateral interactions" between the countries, yet upon investigation, that paper only provides evidence for a select few dimensions that impact international connectivity. Economic engagement is not specified as one of these dimensions in this cited paper. A solution would be to find a solid theory to justify the inclusion of this variable that better captures its necessity in combination with previous colonial status to better understand the relationship between colonial ties and FDI headquarters investment. One such applicable theory is Social Exchange theory (Cook and Cheshire, 2013), arguing that two parties engage in cost-benefit analysis relationships that perpetuate through the strength of social ties, and in this case could explain the necessity of considering economic relations when looking at the effects of colonial ties between nations.

Variable operationalizations

Exports is a poor measure to use to gauge economic interaction between two countries in the colonial-based connectivity variable. It does not capture the full economic relationship between the two countries, as exports may be influenced by other factors aside from economic linkages due to colonialism, such as certain comparative advantages, tariffs, and size of the importing country. Additionally, it is not explained where the authors got the data from, but indicates that it

is from UNCTAD in the appended table. Fixing this problem would require including more variables in the measure to make it more comprehensive of the true economic health between the countries. They could include imports to better understand the two-way economic flow, as well as weighing the variables by GDP to account for the size of the economies. It is unclear whether the data they are using is from one period or over time. If it is only from one period, they could do well to analyze the data over a long time period to better understand how economic relations have evolved since independence was gained. Including these measures would make a stronger case for colonial-based connectivity as a valid measure for understanding how colonial ties continue to impact relationships between past colonies and their colonizers.

Additionally, some of the international connectivity factors they control for could have a better specification. Number of airports is included as a variable, but this level of connectivity would be better gauged by adding seaports as well. While some of these countries have vastness in land for air travel and many airports, many are coastal or smaller sea-faring nations with many ports but fewer air fields. Adding seaports would better capture the extent to which these countries are internationally connected as different types of ports are specific to different countries.

Knowledge connectivity is measured by the share of patent applications made by non-residents, but could be supplemented by the number of expat workers or students between the two countries. Workers and students bring their knowledge to and from international countries, making them likely conduits of knowledge connection.

Estimation technique and empirical testing

The authors face a possible issue of endogeneity in their estimation technique. While the economic engagement variable as measured by exports is hypothesized to determine location choice, it also may be the case that the location also determines how many goods are exported from it. For example, countries with more international seaport locations might export more than other countries with less access to trade overseas, holding other variables constant. One possible instrument that could be determinant of exports, but not necessarily of location choice, is distance from the home country to the location. Since the authors already use distance in the econometric model, it could be done just by removing exports and inverting the quotient term. It

is likely that distance affects how costly it is to transport goods and hence to export them, but is unlikely to affect headquarter location choice as the fixed cost of setting up a headquarters is a one off expense, and distance does not affect the ongoing operations. However, continuously exporting to further distances is costly and less efficient than exporting closer by. Therefore, the distance measure's relation to exports, but lack thereof to location choice, make it a valid instrument to solve for endogeneity in this model.

The regression results show that both colonial-based connectivity measures they use as primary independent variables are positive and significant. However, when looking at just the "former colony" dummy variable, the relationship is negative and significant. As the authors point out, this shows that the economic factors play a large role in determining HQ location, but they neglect to discuss the implications of the former colony dummy actually decreasing the likelihood of HQ location in their past colonizer's country. The authors then claim that colonial-based connectivity has a positive effect on the dependent variable, but it really is just the effect of the economic interaction, with the effects from historical ties actually disproving their hypothesis when looked at in isolation. This is an obstacle the researchers need to overcome, as their colonial-based connectivity variable is not valid for answering their research question as stands. To fix this, the authors would do better to explore the implications of the two results separately, and alter their conclusions accordingly. They should acknowledge that analyzing the economic and historical variables they have specified in tandem yield contradicting implications for the support of their hypothesis, and that their results are inconclusive. Again, either picking more comprehensive metrics for the economic ties portion of their main variable, or disregarding it all together, would be better suited to answer their research question, as it would provide for more concrete support for either proving or disproving their hypothesis.

Overall consistency

The empirical analyses implemented to answer the authors' research question are not sufficient in doing so. The article aims to investigate the extent to which colonial ties influence firms from the colonized country in deciding headquarters location, but the theory and independent variables of interest are misaligned with this goal. The theory provided does support the notion that there are reasons to believe that colonial ties would be a strong indicator of FDI in the form of

headquarter location due to historical relationships that foster knowledge spillover effects, information nodes, and opportunity detectors (Lunnan and Zhao, 2014), and this study attempts to fill in this gap with empirical evidence. However, the authors fail to capture the historical connections they seek to analyze with their theoretical reasoning in the ideation of the “colonial-based connectivity” variable. This problem is further exacerbated in the methods section, where the specification they use for representing historical economic relations as a whole merely accounts for exports from one country to the other. The theoretical and methodological shortcomings are then revealed in the results, showing that the effects of their main independent variable are not robust when the historic effects are detached from one another. These problems reveal a clear disconnect between the stated research question and hypothesis, the results, and the conclusion that the authors present.

Conclusion

The present study's aim to explore the impact of former colonial relationships on foreign headquarter investments in Europe is an interesting and important topic. However, there are some issues with the theoretical framework and methodology used in the study, as outlined in this report. The concept of "colonial-based connectivity" and the sole use of exports as a measure for economic interaction between countries are called into question. Issues of endogeneity also arise in the econometric specification, and are not adequately addressed. Additionally, the failure to fully consider the implications of the regression results for the "former colony" dummy variable are weaknesses in the study. While the findings suggest that historical and economic-based institutional connections play a role in the location choices of foreign headquarters, the study's limitations raise concerns about the validity of the results. Future research should aim to address these issues and develop a stronger theoretical framework to better understand the relationship between historical colonial ties and foreign headquarter investment decisions.

Bibliography

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