Track no 3: Organization, Management and Human Resources of the MNE

Competitive paper

Why the Importance of the (Cultural) Distance Concept in International Business Is Not Justified: A Literature Analysis

ABSTRACT

In this paper we challenge the explanatory power of one of the primary concepts in International Business (IB): the concept of distance. Although in our study we focus on cultural distance and its alleged ability to explain entry mode choice, we hold that our conclusions are equally valid for other distance concepts (such as institutional distance) and further beyond entry mode choice (such as headquarters-subsidiary relations). This paper is part of a project which is based on two pillars: an analysis of 91 prior studies which employed the concept of cultural distance in the context of entry mode choice, and a large scale empirical investigation in over 800 subsidiaries of MNCs. In this paper we report the findings of our literature analysis. Our findings suggest that the explanatory power of the distance concept is highly limited once home and host country effects are accounted for. Based on our results, we propose that entry mode studies in particular and IB research in general should reconsider its fixation with distance measures and, instead, focus their attention on context, particularly home and host country.

Keywords: Coordination; Global operational structures; Headquarter-subsidiary-relationships; Organizational configuration.

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INTRODUCTION

In this article we argue that the ill-advised fixation on the explanatory power of the concept of (cultural) distance and the simultaneous neglect of host and home country context has led the field of IB astray. The fascination of IB researchers with the distance concept can hardly be overstated. Shenkar (2001: 519) affirms "Few constructs have gained broader acceptance in the international business literature than cultural distance." Cho and Padmanabhan (2005: 309) state that ''almost ... no international business study can be complete unless there is an explicit variable controlling for cultural distance''. Finally, Zaheer, Schomaker & Nachum (2012: 19) proclaim: "Essentially, international management is management of distance". In addition to its application in IB, the concept has been employed in most business disciplines, such as strategy, organizational behaviour (OB), human resource management (HRM), finance, accounting and marketing (Shenkar, 2001). Previous contributions have already espoused the many limitations of the (cultural) distance concept (see, for example, Shenkar, 2001; Harzing, 2003; Tung & Verbeke, 2010; Franke, Hill, Ramsey & Richey 2011; Zaheer, Schomaker & Nachum, 2012). Whereas we concur with their concerns, we do not intend to build on this prior research and outline further conceptual weaknesses of the distance concept, but approach this concept from an entirely different angle by empirically testing the explanatory power of the distance concept.

This paper is part of a project which is based on two pillars, an analysis of the literature which applied the cultural distance concept and a comprehensive empirical study. Here we report only on the results of the former. In both parts of our investigation we focus on *cultural distance*, the most frequently used distance concept, which is meant to measure the extent to which two national cultures are similar or different. Nevertheless, we argue that our conclusions are equally valid for other distance measures, such as institutional and language distance. Furthermore, we limit our study to the effects of cultural distance on *entry mode* *choice*. Entry mode choice is arguably the concept that has most frequently been connected to (cultural) distance and, in addition, has been one of the most researched fields in IB (Werner, 2002). Furthermore, Canabal & White (2008) show that research in this area has increased dramatically between 1980 and 2006. A Google Scholar search for articles with entry mode in their title confirms their observation, and also indicates that this increase has continued since 2006. However, we argue that our conclusions regarding entry mode choice are likely to be transferrable to other phenomena that have been related to (cultural) distance, such as the transfer of (HR) management practices, the choice between local and expatriate managers, the performance of foreign subsidiaries, innovation, organizational transformation and technology transfer.

The remainder of this paper will provide first the conceptual background of the cultural distance concept as it has developed in the IB literature. Subsequently, we will present the results of an analysis of 91 studies looking at the impact of cultural distance on entry mode choice. We will argue that instead of cultural distance home or host country characteristics are more likely explanatory factors for any of the relationships found. Finally, we discuss the implications of our findings and present recommendations for future research.

CONCEPTUAL BACKGROUND

Within the literature on entry mode choice, the inclusion of cultural distance as an explanatory variable or control variable has become almost compulsory. As we will see in our review of the prior studies in this field, nearly all of them have used the Kogut & Singh (1988) measure of cultural distance, based on Hofstede's (1980) cultural dimensions. This metric has been subject to trenchant criticism in Shenkar's (2001) JIBS decade award-winning article: "It masks serious problems in conceptualization and measurement, from unsupported hidden assumptions to questionable methodological properties, undermining the validity of the construct and challenging its theoretical role and application" (Shenkar, 2001: 520). Harzing (2003) documented the concept's particular problems in the field of entry mode choice in great detail, and argued researchers in the field suffer from myopia and systematically overestimate the impact of cultural distance.

In spite of this, the popularity of cultural distance as an explanatory variable seems unassailable. The very JIBS issue in which Shenkar received the JIBS decade award for his paper heavily criticising the concept, speaking of "illusions that are at the core of the CD construct" (522), also features a paper co-authored by a prominent IB researcher using the Kogut & Singh metric, acknowledging its problematic nature, but rationalising the choice based on its popularity. Citations to Kogut & Singh (1988) are only increasing: in the first decade after publication the article acquired a 'mere' 74 citations in the Web of Science, whereas more than half of the article's 1,158 citations occurred in the last five years. The vast majority of citing articles refer to Kogut & Singh's paper to justify their measurement of culture rather than to the actual content of the paper.

The tenacity with which entry mode researchers cling to this conceptualization of cultural distance is even more surprising if we take into account the completely contradictory results regarding the influence of this concept related to entry mode choice. Even the field's four meta-analyses report contradictory results: two indicate non-significant results (Tihanyi, Griffith & Russell, 2005; Morschett, Schramm-Klein & Swoboda, 2010), whereas the remaining two (Zhao, Luo & Suh, 2004; Magnusson Baack, Zdravkovic, Staub & Amine, 2008) indicate a negative impact of cultural distance on equity based (i.e. high control) options. However, one of these indicates this is true only for US firms (Zhao et al., 2004), whilst the other reports the conclusion is valid only for European firms (Magnusson et al., 2008). The results for the impact of cultural distance on entry mode choice are so contradictory that they have even spawned quite a large number of articles (e.g. Brouthers & Brouthers, 2001; Wang & Schaan, 2008) that have as their aim to explain this 'paradox'.

However, we argue that this paradox is in fact non-existent and has been created purely through the preferred research practices in this field: the use of secondary data and sophisticated, but black box statistics, combined with the tendency to come up with complex theories to explain effects. By contrast, we argue that these contradictions can be traced to simple home country or host country differences, such as ownership restrictions. We find it striking that these studies seem to completely ignore home and host countries, the very cornerstones of international business. In fact, Brouthers & Hennart (2007: 410) even claim that "[…] theories of entry mode choice originally developed in Western market economies tend to do a good job of explaining mode choice no matter what the origin or destination of the investment" and suggest that "the marginal improvement in explanatory power [of country-level effects] is so small that this additional effort is not warranted."

This paper does not intend to launch another 'attack' on the conceptual and methodological limitations of the cultural distance concept as there have been many studies that have covered these in great detail, albeit so far with little effect in terms of the popularity of this concept. Our critique is at the same time vastly simpler and vastly more wide-ranging: research employing the (cultural) distance concept completely neglected sample composition in terms of home and host country, which has led to wildly varying and sometimes hilarious conclusions. Our plea for (re)discovering the relevance of home and host country context should not be understood only in the narrow sense of our criticism of the distance concept. More importantly, we worry that IB has diverted its attention away from answering "big empirical questions" and instead has become more concerned with filling the boxes suggested by theory and marginally expanding pre-existing explanatory frameworks (Buckley, 2002: 370). Although pleas for the relevance of context in business are by no means new (see e.g., Blair & Hunt, 1986;

Brannen, 1992; Cappelli & Sherer, 1991; Johns, 2006; Redding, 2005; Schneider & Barsoux, 2003; Westney, 1993; Whitley, 1992), most management scholars, and even most IB scholars, have not taken context seriously or have only paid lip-service to it (Johns, 2006). IB scholars, particularly those representing an economics-based strategy perspective, are frequently relying on existing theory and extant data sets which are often a-contextual. The only exception to this might be their reference to the concept of culture which is usually, however, referred to in its static, reductionist and conveniently employable form of cultural dimensions and their country scores (Brannen & Doz, 2010).

Consequently, we cannot agree more with eminent scholars such as Brannen & Doz (2010); Shenkar (2004) and Tsui (2007) who all emphasize the relevance of contextually rich data. Contextual information is not only important to better understand a nation's domestic companies or even an entire business system (or several, in a comparative analysis). It is also relevant for studying the exchanges taking place across different contexts, for example the home and host country contexts of MNCs. Serious engagement with deep contextualization is necessary to pose new and relevant questions, apply existing theories to novel contexts, acknowledge the limitations of existing theories, and develop new and innovative theories that explain empirical phenomena. Ultimately, understanding contextual particularities is also a necessary condition for understanding universalities: it is through the means of comparing contextual particularities across different locations that we can identify common phenomena, and separate them from idiosyncratic particularities or even singularities, which ultimately helps us to discover context-free regularities (see also Pudelko, 2006).

METHODS

To ensure a comprehensive review of prior studies on (cultural) distance and entry mode choice, we evaluated all publications citing the 1988 Kogut & Singh article, which has been the starting point of most research on cultural distance and entry mode choice. We used Google Scholar rather than Thomson Reuters Web of Knowledge (also known as ISI) for our literature search. Google Scholar has a more comprehensive coverage, including not only citations in ISI listed journals, but also citations in books, book chapters, conference and working papers, as well as citations in non-ISI listed journals (Harzing & van der Wal, 2008). The literature review was initially conducted early 2012 and updated just before finalising our article. This resulted in a population of nearly 3,500 articles citing the seminal Kogut & Singh (1988) article.

Subsequently, we narrowed down this large number of articles by only including those that had one or more of the following key words in the title: entry mode, joint venture, acquisition, greenfield, transaction (because of the frequent use of transaction cost theory), equity, or start-up. In addition, we also included all articles that referred to an earlier article that critiqued the role of cultural distance in entry mode research (Harzing, 2003). This left us with a total of nearly 600 references, which were then reviewed one by one to establish their relevance for our current paper.

At the verification stage only papers that dealt with entry mode choice as a dependent variable were retained in our sample. Papers that were deemed not relevant were for instance papers comparing the performance of different entry modes or papers that looked at the role of culture in the relationship between partners in joint ventures. The end result was a sample of 104 papers which were coded based on a list of characteristics which is available from the authors on request. . Of these 13 studies could not be included in our review as their measurement and analyses were so unclear that we could not adequately assess their results. These studies were generally unpublished or published in unknown journals. An Excel spreadsheet with all 104 papers is available from the authors on request. All 91 papers covered in the literature analysis that we conducted are starred in the list of references.

RESULTS

Timing, publication outlets, type of entry modes and type of data used

The 91 studies in our review cover a nearly 30-year period, with the first studies published in 1985 and the last studies published in 2013. Over that period the number of studies has increased substantially, between 1985 and 1999 only 27 studies were published; between 2000 and 2013 this had increased to 54 studies; 30 studies were published in the last 5 years alone. In terms of outlets, about half of the 91 studies were published in mainstream IB journals: Journal of International Business Studies (21), International Business Review (11), and Management International Review (9), with a smattering in Journal of International Management, Thunderbird International Business Review and Journal of World Business. Many top journals in other fields, such as Strategic Management Journal, Organization Science, Management Science, Academy of Management Journal, Journal of Management Studies, Journal of Marketing and Journal of Operations Management are also represented. In total, these 91 studies have appeared in 35 different outlets, illustrating the broad appeal of the topic.

In terms of the type of entry modes that are investigated, more than half of the studies looked at some form of comparison between full and shared control, usually as a choice between a joint venture and wholly owned subsidiary. A quarter of the studies looked at the choice between acquisitions and greenfields, while the remaining quarter looked at equity vs non-equity (e.g. licensing, franchising, exporting, management contracts) entry modes. To ensure comparability between studies, we reduced all entry mode decisions to a choice between high and low control modes. Obviously full control/wholly owned subsidiaries offer more control than joint ventures. In the choice between a greenfield or an acquisition, greenfields represent the high control mode, whereas acquisitions represent the low control mode. In studies comparing non-equity (e.g. licensing and franchising) and equity modes of investment, equity investment was classified as the high control entry mode.

The predominant type of data used in entry mode studies is secondary. Two thirds of the studies (60 studies) used secondary data only, twenty studies used primary data only, seven used both and the remaining four were meta-analyses. Secondary data typically come from annual reports or government databases. With a few exceptions these studies have sample size of at least 500, with many well above 1,000 and some above 10,000. Primary data in this field were collected through surveys to key respondents in multinational companies. Most studies that included primary data had small sample sizes, two thirds had sample sizes under 200, sometimes as small as 31, whereas all but one of the remaining studies between 200 and 350. This provides a first indication that results can easily be influenced by sample imbalances with regard to home or host countries. The four meta-analyses included between 36 and 55 studies that incorporated cultural distance as one of their variables.

Cultural distance and entry mode choice

The type of distance measurement in the studies covered in our review is very homogenous. Out of the 91 studies, 81 used the Kogut & Singh (1988) formula to calculate cultural distance, with the remaining ten only referring to the Kogut & Singh study. Of these 81 studies, *all* used the Hofstede cultural dimensions to calculate cultural distance, with 77 using *only* this source. One study supplemented this with the Schwartz cultural dimensions as well as a perceptual dimension, one supplemented it with the Schwartz and Globe dimensions, one supplemented the Hofstede measures with a perceptual dimension and a final one with updated Hofstede scores provided by Taras & Steele (2006). The two studies that included both the Kogut & Singh index and a perceptive measure of cultural distance found a very low correlation between the two variables: 0.347 (Bell, 1996) and 0.380 (Drogendijk & Slangen). Of the ten studies that did not use the Kogut & Singh (1988) index, four used country clusters, usually Ronen & Shenkar's (1985) clusters, two operationalized the concept as language or other types of distance, three used a perceptual measure of cultural distance, and one did not specify its measurement.

The final results for the relationship between cultural distance and entry mode choice are all over the place: 35% of the studies find a positive effect, i.e., higher cultural distance is related to a high control entry mode choice, 31% find a non-significant effect, and 30% find a negative effect, with the remaining studies finding a curvilinear result. As mentioned before, the four meta-analyses report equally contradictory results. Two meta-analyses indicate non-significant results (Tihanyi et al., 2005; Morschett et al., 2010), although Tihanyi et al. (2005) find that for US based firms there is negative relationship between cultural distance and entry mode choice.[1] The remaining two (Zhao et al., 2004; Magnusson et al., 2008) indicate a very small negative impact of cultural distance on equity based (i.e. high control) options. However, one of these indicates this is true only for US firms (Zhao et al., 2004), whereas the other reports the conclusion is valid only for European firms (Magnusson et al., 2008).

Home and host countries included in the studies

From our review above, it is clear distance does not seem to have a consistent relationship with entry mode choice. We argue that any significant relationships between cultural distance and entry mode choice are likely to be due to specific home/host country characteristics for variables that *do* influence entry mode choices. We therefore review the composition of

[1] The authors come up with what, in our view, is a rather contrived argument explaining this relationship, namely risk propensity of the home country measured as Hofstede's uncertainty avoidance. They argue that MNCs from low uncertainty avoidance cultures such as the US, UK and Sweden display a significant negative relationship between CD and entry mode choice, whereas MNCs from high uncertainty avoidance countries such as Japan and Korea do not. However, this is likely to be caused by host and home country effects. MNCs from the US, UK or Sweden invest in both Western and Asian countries, but are not able to use full control options or acquisitions in culturally distant Asian host countries for reasons unrelated to CD. MNCs from Japan and Korea have a strong preference for greenfields or joint ventures and use this entry modes in both Western and Asian countries.

home/host countries in the individual studies. With regard to the *home* countries covered in these 91 studies, the vast majority of studies look at a single home country. The United States (17) and Japan (16) occur most frequently, while the Netherlands (8) and Spain (7) are also popular. The remaining studies are either meta-analyses (4), do not specify the countries included (5) or cover a wide range of other single home countries (Brazil, China, Denmark, Finland, Germany, France, Italy, Korea, Singapore, Sweden, Taiwan, Turkey). Only nineteen studies include multiple home countries. In terms of host countries, the majority of studies (49) include multiple *host* countries, varying from 4 to 90 countries. For studies looking at single host countries, the most popular host countries are the USA (6), China (4) and Turkey (3). The remaining studies are either meta-analyses (4), do not specify the countries included (8) or cover a range of other host countries (Caribbean, Japan, Korea, Singapore, Slovakia, Vietnam).

There are only *seven* studies that include both multiple home and multiple host countries. This means that it is entirely possible that the remaining 84 studies are merely measuring host country or home differences for those variables influencing entry mode choice, such as investment restrictions, rather than cultural distance effects. These studies are in fact suffering from a fatal design flaw by keeping the home or host country fixed in each comparison. Thus all they are capturing is variance in host or home countries. We are not the first to suggest that home and host country effects might be a more likely explanation for entry mode choice than cultural distance. In an unpublished conference paper, Slangen and Hennart (2001) identified the lack of recognition of home or host country effects in their survey of the literature on greenfield/acquisitions, but did not pursue this problem in any detail. Harzing (2003) presented a review of all 30 studies on cultural distance and entry mode choice to that date and suggested that home and host country effects might at least be equally plausible explanations for differences in entry mode choice as cultural distance. However, she was unable to validate this argument empirically, something that we are able to do in this article. Most recently, in a paper presented at the 2013 AIB meeting, Maseland and van Hoorn (2013) made a very similar case by focusing on institutional distance, i.e. they argued it might be home and host countries that matter, not institutional distance. However, their paper is very measurement oriented and does not draw any broader ranging conclusions with regard to IB research. It also does not illustrate how this design flaw would impact on key decisions in the IB literature, such as for instance entry mode choice, the transfer of (HR) management practices, the choice between local and expatriate managers, the performance of foreign subsidiaries, innovation, organizational transformation and technology transfer. Finally, they assume that if it isn't institutional distance that matters, then it must be the institutional profile of the home or host country. However, all we can establish from their paper and our review of the entry mode literature is that it is host or home country characteristics that matter. *Which* characteristics are responsible for a particular phenomenon (such as entry mode choice) depends on the respective phenomenon and the respective home and host country. Hence our plea to focus more closely on context in entry mode choice research in particular, and in IB research in general and thoroughly search for specific explanatory factors on a case by case basis rather than settle for the first variable that just correlates with the characteristics that *do* matter.

Home and host country context and entry mode choice

If we take a closer look at which home and host country characteristics could be expected to matter for entry mode choice, this might be specific home or host country *cultural traits* (rather than cultural *distance*) or specific home or host country *institutional traits* (rather than institutional *distance*). With regard to *host country characteristics* the following institutional characteristics are likely to be particularly relevant factors to explain entry mode choice: political risk, economic development and government restrictions. A high degree of political risk, or in more general terms country risk, could speak in favour of low risk entry mode choices such as non-equity or shared control investments (see for example Gatignon & Anderson, 1988; Kim & Whang, 1992; Bell, 1996; Barkema & Vermeulen, 1997). A low level of economic development is equally likely to lead to non-equity investments, given the limited market opportunities, and to greenfield investments, due to a lack of acquisition candidates (see e.g. Davidson & McFetridge, 1985; Cho & Padmanabhan, 1995). A particularly 'hard factor' that might not even leave an MNC any choice in its entry mode are host government restrictions. Governments can coerce MNCs to form joint ventures with a domestic partner, for example to enforce technology transfer in exchange for market access. China is a prime example for the successful application of this policy (Long, 2005). Home countries, certainly home countries that usually feature in entry mode studies, are frequently from the highly industrialised West. From their perspective culturally distant host countries in Asia, Latin America, Eastern Europe or Africa are characterised by a high degree of political risk, a low level of economic development and a high level of government restrictions on entry mode choice. As a consequence, institutional host country characteristics such as political risk, economic development and government restrictions are likely to be highly correlated with cultural distance (Harzing, 2003). So we would argue that host country differences are a much more likely explanatory factor for entry mode choice than cultural distance with which they correlate.

This means that in all studies that do *not* include host country factors as a control variable, which is the case for the vast majority of studies on entry mode choice[2], cultural distance is likely to be nothing more than a proxy for factors that *really* matter, namely host country characteristics such as political risk, economic development and government restrictions. A

[2] The few studies that did include one or more of these host country factors found insignificant results for the impact of cultural distance on entry mode choice. For instance, in Cho & Padmanabhan's (1995) study the significant effect of CD disappeared when a single host country dummy, developed vs less developed, was included. In Eramelli's (1997) study CD and many other host country variables (political risk, market potential, government restrictions) suffered from multicolinearity. Hence, once a host dummy (developed/less developed country) was included, CD was no longer significant.

representative study is Agarwal's (1994) investigation of 148 entry-mode decisions of U.S. MNCs which found cultural distance to be positively related to joint ventures. Despite the fact that this study featured no less than 20 host countries, more than 40% of the total sample consisted of only three countries: Japan, the U.K. and Canada. The only host country in this study with a significant number of joint ventures was Japan (with more than 80% of entries into the country being joint ventures). We argue that the dominance of joint ventures as a gateway into Japan might be entirely unrelated to cultural distance. Instead, a more likely reason for the high level of joint ventures in Japan could be the frequently described difficulty for outsiders to enter the tightly knit domestic distribution channels. And even if we were to follow the argument that cultural distance is the cause for the preference for joint ventures in Japan, this rationale would not hold for other host countries. France and Italy, for example, are culturally more distant to the U.S. than Canada and the U.K., so US MNCs should be more likely to use joint ventures in these countries than in Canada and the U.K. However, the percentage of joint ventures for France and Italy are a mere 13%, whereas for Canada and the U.K. they are 14% and 20%, respectively.

Furthermore, in many of the studies we analysed, *home country characteristics* are just as likely to explain variation in entry mode choice as host country characteristics. Of particular relevance might be the cultural dimensions uncertainty avoidance and short vs long term orientation. MNCs from a high (low) uncertainty avoidance country might opt for a greenfield (acquisition) investment, as might MNCs from a long (short) term orientation country. A country which is heavily invested in other countries and which ranks very high on uncertainty avoidance and long term orientation is Japan. And indeed, its corporations are well known for their strong preference for greenfields over acquisitions and for joint ventures (see e.g. Anand & Kogut, 1997; Chang & Rosenzweig, 2001; Anand & Delios, 2002; Kamal, 2009). By contrast, many Western countries rank lower on uncertainty avoidance and are more short-term oriented and, as has been established, their MNCs frequently prefer significantly more acquisitions (Anand & Kogut, 1997). As MNCs from these home countries often invest in culturally distant countries, cultural distance and home country characteristics with regard to uncertainty avoidance and time orientation can be expected to correlate, but, again, this does not mean that cultural distance explains entry mode choice.

Wilson (1980) provided an excellent example of specific home country-based preferences for entry mode choice. He linked the relatively strong inclination of British MNCs for acquisitions to their long tradition of a market for corporate control. According to his study 46% of the entries of British corporations into foreign markets were acquisitions instead of greenfields, compared to just 9% for the entries of Japanese corporations and 28% for entries of firms of other nationalities. Many other studies since have confirmed this pattern for British companies (see e,g Healy & Palepu, 1993; Anand & Kogut, 1997; Chang & Rosenzweig, 2001). So any study on entry mode choice that includes only one host country is likely to simply capture differences in ownership preferences of corporations of various home countries rather than the effect of cultural distance on entry mode choice.

Kogut & Singh's (1988) original study that started the whole 'industry' of research on cultural distance in entry mode choice is an excellent case in point. The authors included 506 entry-mode choices of MNCs from more than 15 home countries investing in the U.S. and found cultural distance to be positively related to a choice for greenfields at a 0.10 level of significance. Yet again, noteworthy is the sample on which their study is based. Two thirds of the MNCs included were Japanese, British or Canadian. Consequently, the established correlation between cultural distance and entry mode choice might well have been found on the basis of a mere home country effect: As we have already seen, Japanese MNCs show a significantly higher than average preference for greenfields, whereas British (and Canadian) firms demonstrate a significantly higher than average preference for acquisitions. Kogut and Singh's

(1988) conclusion that cultural distance is the cause for their findings can in our view not be upheld unless we investigate entry mode choices of Japanese as well as British and Canadian MNCs in both culturally similar and dissimilar countries. In this respect, comparative studies on acquisitions as entry modes by home country (see Healmy & Palepu, 1993) indicate that any such home country acquisition preference is stable and not subject to host country differences. Many later studies show the same effect, for instance the positive effect of cultural distance on joint ventures in Finland in Hennart & Larimo's article (1998) is likely to be a simple difference in ownership preferences between U.S. and Japanese firms, the only two home countries in the study. And finally, in Chang & Rosenzweig (2001) the positive relationship between cultural distance and greenfields reflects the differential preference for greenfields between Japan, which made up 58% of the sample and the various Western home countries.

Of the seven studies that did include multiple home *and* host countries, one featured only Scandinavian home countries (Larimo, 2003), which have virtually identical scores on Hofstede's dimensions, so effectively this study is likely to have measured host country effects not cultural distance. Another study (Arora and Fosfuri (2000) included only three home countries/regions with two thirds of the sample composed of the U.S. and Japan. Hence the results are likely to reflect differences in home country investment preferences. As this study also included domestic investments, its key result (in culturally distant countries franchising is more likely than wholly owned subsidiaries) might well be caused by the higher likelihood of wholly owned subsidiaries in the home country. A third study included four Western home countries that score very similarly on several of Hofstede's dimensions and five Eastern European host countries. The negative relationship between cultural distance and a high control entry mode might again well be a host country effect. Russia and Romania are more culturally dissimilar[3] to the Western home countries than Hungary, Poland and the Czech Republic, but at the same time have very different political environments than the latter countries.

The remaining four multiple home/host country studies found non-significant results, even though some predicted a positive (Pangakar & Klein, 2001; Harzing, 2002) and others a negative (Ackmerman, 2005; Estrin et al., 2007) relationship between cultural distance and a high control entry mode option. Two of these studies (Harzing, 2002; Ackerman, 2005) found non-significant results only once host region dummies were included. Particularly noteworthy is the study by Pangarkar & Klein (2001) as it offers the useful opportunity to isolate the effect of cultural distance. Most other studies on entry mode choice include host countries that vary significantly in terms of political risk, economic development and government restrictions, factors that, as we have seen, often correlate with cultural distance, and include only cultural distance as independent variable. This study, however, is based on a sample which includes a series of Western home and host countries which are quite similar on these country characteristics but are, at the same time, culturally relatively distant from each other. And, as mentioned, Pangarkar and Klein found no significant relation between cultural distance and entry mode choice.

Nevertheless, the appeal of the cultural distance concept seems to be so strong that even in the face of clear evidence that it is not applicable, authors still attempt to salvage the concept. For instance in a study that looked at the choice between greenfields and acquistions in the USA, Elango (2005) showed that the effect of cultural distance on greenfields disappeared when only two home country dummies were included: the U.K. and Japan, which made up nearly two thirds of the sample. This is only natural given that, as we have shown above, U.K. firms have a strong preference for acquisitions and Japanese firms have a strong preference for

[3] The scores on the cultural dimensions used in this study for the Eastern European countries came from an unpublished Master's thesis and were very different from those subsequently published by Hofstede. Hence the results with regard to CD might not be reliable.

greenfields. However, Elango then reasons this finding away by saying “this lack of significance is not entirely surprising, as country dummies are poor proxies for cultural and other differences across nations”. We wholeheartedly agree that country dummies are poor proxies for cultural distance, but the significance of home country dummies in Elango’s study and of host country dummies in other studies shows that we should look at home and host country characteristics to explain entry mode decisions, not cultural distance.

DISCUSSION

Summary of key findings

Our literature analysis revealed that about one third of all studies that employed the cultural distance concept to explain entry mode choice found one effect, another third the opposite effect and the last third no effect at all. This confusion was mirrored by meta-analyses, which also presented very different results. We concluded that the cultural distance concept is not only a poor predictor of entry mode choice, but also that studies employing the cultural distance concept have merely been measuring home or host country differences for those factors that *really* influence entry mode choice, such as cultural traits like uncertainty avoidance and short vs long term orientation, or institutional traits like political risk, economic development and government restrictions.

The relevance of home and host country effects: Asian vs. Western countries

A substantial of the studies we investigated are based on a comparison between Western and Asian countries. However, we have shown that Asian MNCs have a much stronger preference for greenfield investments compared to Western MNCs *irrespective* of the host country and, hence, cultural distance (home country effect). Furthermore, we have seen that entries into Asia are preferably done via greenfields, whereas entries into Western countries occur more often via acquisitions *irrespective* of the home country and, hence, cultural distance (host country effect).

We can distinguish a number of underlying reasons for the different entry mode patterns in Asian as opposed to Western home and host countries. First, equity markets in the West tend to be more active and less restrictive, and characterized by a more dispersed ownership structure, rendering the option of acquiring companies in Western countries more feasible (Slangen & Hennart, 2001). This host country difference might have a spill-over effect on home country differences as well. As Asian companies are, due to the institutional difficulties of acquiring companies on their home turf, less used to these transactions, they simply might not have the necessary experience to embark on such acquisitions, even in Western countries where the institutional conditions for such an entry mode strategy are more suitable. Another reason for different entry mode strategies might be linked to the fundamentally different strategies of managing the multinational network. US and European companies often pursue a polycentric strategy that leaves more autonomy for local units. This strategy is often well suited for acquired companies which already have established corporate cultures and strategies. In contrast, Japanese companies in particular follow a more ethnocentric strategy which is more standardized around HQ practices. Such a focus on HQ practices, however, renders the management of acquired firms more complex, and hence is likely to lead to a preference for greenfields.

In terms of host countries, companies might prefer entering developing host countries via greenfields, over which they have more control (for example to assure their quality standards). While this argument might hold for China and to some extent for Korea, Japan is of course different as it is a highly developed country. Even so, host country specific cultural and institutional traits might provide a powerful explanation for entering this country via the greenfield route. Japanese companies adhere to the shareholder philosophy to a much lesser extent than most Western companies and are more concerned about their employees as key stakeholders. Therefore, it becomes essential for management to keep their company independent and to fend off any attempt of being bought up by another company, in particular a foreign one. Consequently, it is much more difficult for foreign companies to find possible take-over candidates in Japan. Japanese companies can typically only be acquired if they are close to bankruptcy, as only the continued existence of the company matters more than its independence. Similar arguments can be made for Korean and Chinese companies which also tend to cherish their independence and long-term growth possibilities more than the short-term gain of their shareholders. In addition, in China most companies are still state owned enterprises which makes purchase by foreign companies very difficult. These arguments are as valid for culturally distant Western headquarters as for culturally closer headquarters in other Asian countries. In other words, it is not cultural distance that matters, but the institutional environments in home and in particular host countries.

Possible extensions of our study on (cultural) distance

In our study we concentrated on *cultural* distance as the most frequently used distance concept and its relevance for *entry mode choice*, the most often studied phenomenon in the context of distance. We would argue that by broadening the focus also to other distance measures such as institutional and language distance, our key findings – poor explanatory power of the distance concept; much higher relevance of home and host country context – would equally be valid. A further extension to our study would be to investigate the explanatory power of the distance concept in relation to other phenomena. Previous studies have already related the distance concept, among others, to the transfer of (HR) management practices, the choice between local and expatriate managers, the performance of foreign subsidiaries, innovation, organizational transformation and technology transfer. Whereas we have not included such studies into our literature analysis, we expect that our key findings would hold equally for these and other phenomena. To provide an example, we would suggest that the extent to which, say, a British MNC transfers its HRM practices to its German and Polish subsidiaries will be influenced more by host country labour market regulations than by (cultural) distance. This implies that even though the cultural distance between the UK and Germany is, according to Hofstede's value dimensions and, consequently, the Kogut & Singh formula, significantly lower than the distance between the UK and Poland, the potential to transfer HRM practices will not necessarily be higher, because of the highly regulated German labour market.

Furthermore, we emphasize that *any* study investigating *any* distance dimension with reference to *any* phenomenon would need to include *several* home and host countries (and select them on valid theoretical grounds) in order to be able to separate distance from home/host country effects. In the field of entry mode choice, there were almost no studies that adhered to this methodological requirement. The main outcome of our current study is therefore not a statement on the extent to which (cultural) distance makes a difference, but an argument that home and host country context provides a simpler, yet more powerful alternative to the distance concept. If, however, one wanted to actually test whether (cultural) distance has any real explanatory power, we would recommend the following: choose a country sample for which (cultural) distance is high (e.g., between Latin European and Nordic countries), but for which fewer differences in other context variables such as labour market or investment restrictions exist, for example due to common EU regulations. Such studies, however, have so far been rarely, if ever, conducted.

CONCLUSION

We believe that our study has made a number of significant contributions. First, we showed that *any* study examining the impact of *any* distance dimension on *any* empirical phenomenon would need to include *several* carefully chosen home and host countries to be able to differentiate distance from home/host country effects. The chief contribution of our research was, however, to establish that home and host country context is likely to have a significantly higher explanatory power for entry mode choice, and quite possibly many other IB phenomena, than the distance concept. Consequently, we would like to see more studies in IB that follow our suggestions and incorporate home and host country context in lieu of the distance concept.

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