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Investment motive as a moderator of cultural-distance and relative knowledge relationships with foreign subsidiary ownership structure

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ABSTRACT

In this analysis, we seek to contribute to the growing body of literature exploring moderators of cross-national differences and foreign subsidiary ownership structure relationships, by developing the argument that cultural distance and majority-owned foreign subsidiary relationships will be positively moderated if a subsidiary serves a manufacturing motive, as opposed to a market-seeking motive. Additionally, we argue that relationships between increasingly greater levels of host country technical knowledge, relative to a firm's home country, and the use of majority-owned foreign subsidiary structures will be negatively moderated by manufacturing motives. These ideas are tested, and supported, in the empirical context of subsidiaries of Japanese automotive firms from 1993 through 2009.

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1. Introduction

Ever since Kogut and Singh's (1988) seminal article linking cultural distance (CD) and foreign subsidiary ownership structures, international business researchers have been exploring this relationship in different empirical contexts (e.g., Anand & Delios, 1997; Chan & Makino, 2007; Erramilli & Rao, 1993; Herrmann & Datta, 2002; Pan, 1996; Slangen & van Tulder, 2009; Xu, Pan, & Beamish, 2004; Zhao & Zhu, 1998). Yet, an examination of this impressive body of work suggests that any *direct* relationship between CD and foreign subsidiary ownership structures is unclear, as there are competing theoretical arguments for this relationship and empirical results have been mixed. Furthermore, a meta-analysis conducted by Tihanyi, Griffith, and Russell (2005), only identified a negative overall effect size that was “small and close to 0,” and similar results were found in a meta-analysis conducted by Zhao, Luo, and Suh (2004).

In an attempt to offer clarity in our understanding of this topic, a number of researchers have made contributions to a growing body of literature that seeks to explore the potential moderators of CD-foreign subsidiary ownership structure relationships (e.g., Agarwal, 1994; Brouthers & Brouthers, 2001; Cho & Padmanabhan, 2005; Lopez-Duarte & Vidal-Suarez, 2013; Schwens, Eiche, & Kabst, 2011; Zhang, 2015). The first objective of the current study is to contribute to this growing body of research by exploring the potential *moderating*

role of foreign investment motives on CD-foreign subsidiary ownership structure relationships. To pursue this first objective, we argue that if an MNE is investing to engage in manufacturing activities requiring a high degree of coordination across its multinational network, then significant cultural differences may encourage investments that facilitate greater parent-firm coordination over activities (i.e., majority-owned subsidiaries), to ensure that the subsidiary is operating in sync with the MNE's entire multinational network. At a higher level of abstraction, investing for manufacturing motives reflects the more general “efficiency-seeking” objective identified by Dunning, which is mainly production-cost related (1998). On the other hand, if an MNE is investing to engage in activities requiring a high level of local market knowledge, as in the case of investing for “market-seeking objectives” (Dunning, 1998), then significant cultural differences may encourage investments that facilitate greater access to local knowledge through partnerships with host-country firms (i.e., minority- or equally-owned subsidiaries).

Additionally, the nascent literature on relationships between differences in technical knowledge production across countries and foreign investment decisions (e.g., Berry, Guillen, & Zhou, 2010; Zhang, 2015) should be relevant to this analysis because accessing technical knowledge is often an element of internationalization motives (Berry, 2006; Guler & Guillen, 2010; Nachum, Zaheer, & Gross, 2008). Hence, the second objective of this research is to contribute by exploring the potential *moderating* role of foreign investment motives on knowledge difference-foreign subsidiary ownership structure relationships. More specifically, we argue that when host nations have a greater level of

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technical knowledge production than the home nations of investing foreign firms, foreign firms investing for manufacturing motives will be more likely to seek ownership structures that share greater levels of equity with local partners to access technical and process knowledge.

And finally, the majority of studies linking CD to foreign subsidiary ownership structure, do so in the context of entry modes. Yet, a number of authors have noted that simply looking at foreign subsidiary ownership structures at entry offers an incomplete picture because the issue of ownership structure in the face of home- and host-country differences is likely to remain strategically relevant long after the point of entry (Powell & Rhee, 2016), and focusing on the static point of entry does not acknowledge that ownership strategy is likely to be an “evolutionary” process (Ando, 2012). Hence, the third objective of this analysis is to contribute to the growing subset of literature on ownership structure that considers foreign subsidiary ownership structure relationships without limiting analyses to the point of market entry (e.g., Ando, 2012; Padmanabhan & Cho, 1996; Pan, 1996; Powell & Rhee, 2016; Xu et al., 2004; Yamin & Golesorkhi, 2010; Zhang, 2015). Given the nature of this third objective, we acknowledge that ownership structure can differ systematically by subsidiary age, making it important to employ panel data while examining country difference and foreign subsidiary ownership structure relationships and controlling for subsidiary age.

We explore these ideas by making the distinction between the foreign investments of Japanese automotive firms for manufacturing motives, as opposed to market-seeking motives, as illustrated in fig. 1. In this empirical context, manufacturing requires a high level of coordination within a firm's multinational network, and market-seeking investments require local-market knowledge in order to successfully market products. Additionally, we argue that manufacturing partnerships offer greater opportunities to acquire technical and process knowledge that can be more directly and immediately applied to operations.

2. Background

2.1. Manufacturing, cultural distance, and ownership structure

Cultural distance is one of the most explored and debated constructs in the international business literature. Certainly, an exhaustive review of the literature and debate surrounding this construct is beyond the scope of this analysis. Yet, in the current study it is important to note

that researchers have drawn upon Johanson and Vahlne's (1977) psychic distance construct to argue that CD can be a source of uncertainty and inefficiency for MNEs (Kogut & Singh, 1988). This idea has led to two arguments for relationships between CD and foreign subsidiary ownership structure, and these arguments entail opposite predictions. In the first case, greater levels of CD discourage majority-owned foreign subsidiary structures as MNEs seek to reduce their risk exposure (Brouthers & Brouthers, 2003; Grosse & Trevino, 1996; Kim & Hwang, 1992) and learn about host-markets through partners (Barkema, Bell, & Pennings, 1996). In the second case, greater CD encourages majority-owned subsidiaries, because large cultural differences result in additional transaction costs related to sharing information and coordinating activities (Hennart & Reddy, 1997; Li & Guisinger, 1992). As a result of these increased transaction costs, the second argument suggests that MNEs will seek greater levels of managerial control to internally coordinate activities and manage interdependencies in the face of greater CD (Hennart & Reddy, 1997; Li & Guisinger, 1992). In addition to the competing theoretical arguments for CD-foreign subsidiary ownership structure relationships, empirical findings on this relationship have also offered conflicting results as indicated in Table 1, which highlights selected and relevant empirical studies identifying different relationships.

In the current study, we argue that both of the theoretical mechanisms for direct CD-foreign subsidiary ownership structure relationships are plausible, but they may occur under different conditions, largely determined by the motives behind foreign investments. Additionally, failure to account for the different motives behind foreign investments may offer one explanation for inconsistent empirical results within this literature stream. Hence, this analysis represents a contribution to the literature that has explored potential moderators of the CD-foreign subsidiary ownership structure relationship (e.g., Brouthers & Brouthers, 2001; Lopez-Duarte & Vidal-Suarez, 2013). This growing body of research has often considered the role of home-country firms' past experiences as a moderator in CD-ownership structure relationships (e.g., Agarwal, 1994; Cho & Padmanabhan, 2005; Schwens et al., 2011), or a potential moderating role for characteristics of the host-country institutional environment (e.g., Brouthers & Brouthers, 2001; Chang, Kao, Kuo, & Chiu, 2012). Table 2 offers a list of selected and relevant studies in this area, along with their findings on moderated CD-foreign subsidiary ownership structure relationships.

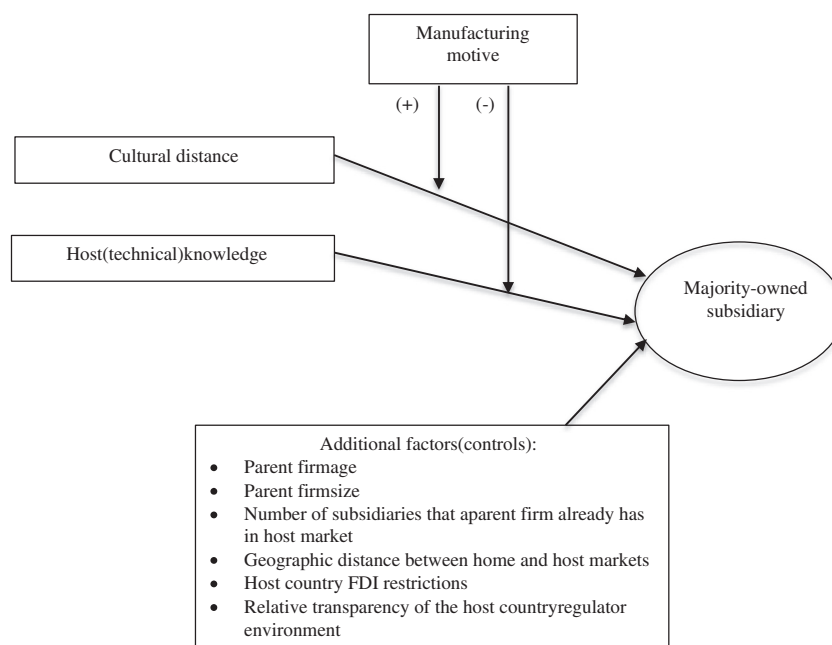


Fig. 1. Conceptual model.

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