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Psychic distance and ownership in acquisitions: Direction matters

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ABSTRACT

Recent research has begun to explore the impact of country-of-origin and direction on internationalization decisions in response to controversy over the use of symmetrical and absolute values of distance. In this paper we contribute to this stream of research by studying the moderating influence of direction on the distance–ownership relationship as it relates to cross-border acquisitions. We ground our arguments in transaction cost economics and supplement this lens using institutional theory to contextualize the home–host country relationship through moderating effects. Through our study of 25,440 full and partial acquisitions (9577 MNEs, 25 countries, 15 years), we demonstrate that the distance–ownership relationship is moderated by direction. We further find that acquisition ownership decisions made by emerging country MNEs differ significantly from those made by developed country MNEs. Our findings demonstrate that future research on the impact of distance should consider the differences between MNEs from emerging versus developed economies, in addition to host country characteristics.

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1. Introduction

In 2014, MNEs from emerging economies (EMNEs) were responsible for 39% of global foreign direct investment (FDI) outflows (i.e. \$553 billion), compared to only 12% at the start of the 21st century (UNCTAD, 2014). Despite this tremendous growth, much of what we know about the internationalization of MNEs (e.g. entry mode and ownership structure) stems from theoretical and empirical studies performed on multinational enterprises from developed countries (DMNEs) (Ramamurti, 2012).

Through research on DMNEs, three theoretical strands of research help predict how firms will internationalize under the influence of distance. First, transaction cost economics suggests that firms entering distant host markets will choose lower commitments due to both external uncertainty (volatility of the host environment) and internal uncertainty (the firm's perceived inability to operate in such environments) (Zhao et al., 2004). Second, the resource based view tells us that firms may seek out partial ownership if they have intermediate levels of knowledge of the local market (Erramilli, 1991). Third, the Uppsala model (Johanson and Vahlne, 1977) suggests that firms will incrementally internationalize before engaging in FDI in uncertain and distant environments, in order to gain the knowledge (i.e. experience) required to enter those markets. Given that these findings are based on research performed on MNEs from developed countries, this paper calls into question the applicability of these theoretical findings to

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EMNEs, as other recent research has done (e.g. Cuervo-Cazurra, 2012; Gammeltoft et al., 2010; Guillen and Garcia-Canal, 2009; Hennart, 2012; Narula, 2012; Ramamurti, 2012).

Cuervo-Cazurra (2012) and Gammeltoft et al. (2010) argue that researchers are divided on the applicability of current theories to EMNEs. Some researchers consider EMNEs as a relevant stream of research that requires new theories (e.g. Hennart, 2012; Mathews, 2006), while others argue that previous theories still stand (e.g. Rugman, 2009) but that the study of EMNEs may help to extend current theories (e.g. Cuervo-Cazurra, 2012). Our interests lie within the argument that current theories can be further explored by considering the moderating effect of both the MNE's home and host country (of investment) on ownership decisions, specifically when employing an acquisition entry mode. As we are interested in differences between EMNEs and DMNEs, we side with researchers who call for the theoretical incorporation of direction when using the concept of distance (e.g. Ambos and Håkanson, 2014; Håkanson and Ambos, 2010; Hernández and Nieto, 2015; Shenkar, 2001; Yildiz, 2014; Zaheer et al., 2012). As such, our research begins with the theoretical and empirical findings on the influence of distance on acquisition ownership decisions, and follows with an investigation of the influence of home and host countries (i.e. either emerging or developed countries) on this process, to incorporate direction.

We bound our argument through the lens of TCE by focusing specifically on psychic distance, a formative construct that represents the flow and interpretation of information to and from a foreign country (Håkanson and Ambos, 2010). As psychic distance influences the firm's perception of uncertainty in the internationalization decision, we explore how the MNE's home and host country moderates the influence of psychic distance on ownership decisions in the acquisition process. As we ground our arguments in TCE theory, we hold constant both external uncertainty (i.e. context) of the host country, along with the MNE's experience in the host country, thus responding directly to Zaheer et al. (2012)'s call to incorporate firm level variables (i.e. firm experience).

We argue for the use of psychic distance as a means to explore the impact of distance, as it considers contextual factors that influence managerial cognition. We focus on Håkanson and Ambos' (2010) recent operationalization of psychic distance, as it acknowledges criticisms of previous measures by considering asymmetry – that is, psychic distance does not consider the distance between two countries to be absolute, rather it is based on managerial perceptions of the host country's distance from the home country. As it implies, psychic distance is a cognitive measure, based on human perceptions, acknowledging the bounded rationality of managers, based on what they know (or think they know).

In this study, we establish the relationship between psychic distance and ownership structure in acquisitions (full vs. partial) and then investigate the moderating influence of direction, as defined by home/host country institutional environment (i.e. emerging or developed countries). The scope of our study includes a large body of data that investigates the 25,440 ownership acquisition decisions of 9577 MNEs from 25 different countries over a 15-year period.

Through our study, we demonstrate that the distance- ownership relationship in acquisitions is moderated by direction. We also find that the behaviour of DMNEs differs significantly from that of EMNEs: EMNEs acquire higher ownership when internationalizing to countries with large psychic distance, while DMNEs acquire less ownership. Conversely, when EMNEs enter emerging economies where distance is small, they acquire less ownership. Our findings demonstrate that future research on the impact of distance should consider the differences between MNEs from emerging versus developed economies, specifically as it relates to the motivation behind their internationalization decisions.

This paper is laid out as follows. In the theoretical section, we discuss the influence of distance and direction in the internationalization process (2.1) and the relationship between distance and ownership decisions (2.2). In Section 2.3, we discuss the differences between the strategic intents of EMNEs and DMNEs, and how these differences call for the integration of direction as a moderator to the relationship. Section 2.4 introduces our hypotheses that argue for different ownership decisions depending on direction. Our Methods section presents the testing of our hypotheses (Section 3), followed by the results and discussion (section 4). We conclude with a discussion on the implications of our findings (section 5).

2. Theoretical background

2.1. Distance and direction in the internationalization process

Research shows that firms will make internalization decisions based not only on the uncertainty of the host country's market (external uncertainty), but also on the uncertainty within the firm, where uncertainty is characterized by the distance between the MNE's home and host country (Anderson and Gatignon, 1986). As such, the concept of distance (between home and host country environments) has become a key independent variable when exploring the internationalization process of MNEs.

Distance, however, has been conceptualized in a variety of ways. Beckerman (1956) introduced the concept of psychic distance to explain the perceived (subjective) differences between home and host countries affecting the internationalization of Swedish companies (Håkanson and Ambos, 2010). Kogut and Singh (1988) created an index of cultural distance, a construct that incorporated Hofstede's (1984, 2001) dimensions of culture, which was further developed by measures from Schwartz (1992, 1994) and the GLOBE study (House et al., 2004).

Over time, researchers broadened the scope of distance to include additional dimensions. For example, Ghemawat (2001) proposed four dimensions of distance (cultural, administrative, geographic, and economic distances), while Berry et al. (2010) proposed nine (cultural, administrative, economic, financial, political, demographic, knowledge, political and connectedness). Kostova (1999) introduced the concept of institutional distance as a means to broadly capture differences between countries, including not only cultural

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