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Motive meets experience: Cultural distance, motive, related experience, and foreign subsidiary ownership structure

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ABSTRACT

Relationships between cultural distance (CD) and the use of majority-owned foreign subsidiary ownership structures may differ for manufacturing and non-manufacturing investments. Firms may use majority-owned ownership structures to reduce 'internal' uncertainty and cost associated with having culturally dissimilar partners in manufacturing investments. Alternatively, for non-manufacturing investments, firms may be less likely to use majority-owned structures, because local partners can help reduce uncertainty and costs at the interface between the subsidiary and the 'external' host market. This analysis extends these ideas by arguing that the moderating effect of related experience should also differ between manufacturing and non-manufacturing investments. In the context of foreign non-manufacturing subsidiaries of Japanese automobile firms, we find that related experience positively moderates a negative relationship between CD and majority-ownership foreign subsidiary structures. Alternatively, for manufacturing subsidiaries of Japanese automobile firms, we find that related experience negatively moderates a positive relationship between CD and majority-ownership structures.

1. Introduction

This analysis extends a growing body of research that identifies different cultural distance (CD) and foreign subsidiary ownership structure relationships depending upon investment motive. Decisions on foreign subsidiary ownership structure are strategically important for parent firms at the point of market entry (Lo, 2016; Samiee, 2013) and well after the establishment of a foreign subsidiary (Ando, 2012; Lo, 2016; Powell & Rhee, 2016; Zhang, 2015). Consistent with past research (e.g., Gatignon & Anderson, 1988; Hennart, 1991; Powell & Lim, 2017; Xu, Pan, & Beamish, 2004), we distinguish between two types of foreign subsidiary ownership structures, foreign subsidiaries where a parent firm owns a majority of the equity, and those where a parent firm does not. A key challenge facing firms that invest in foreign markets is overcoming gaps between the knowledge stocks that they have accumulated through experiential learning over the course of the firm's history, and the knowledge stocks required to operate effectively in host markets (Hutzschenreuter & Matt, 2017; Powell & Rhee, 2016). These knowledge gaps enhance the liability of foreignness of an investing firm (Johanson & Vahlne, 1977), and can result in various types of uncertainty and costs (Erramilli & Rao, 1993; Hennart, 1988). Gaps in knowledge stocks related to host market culture may be especially challenging (Delios & Henisz, 2003; Kogut & Singh, 1988; Slangen & Van Tulder, 2009), and may relate to decisions on foreign subsidiary ownership structure.

Recent research has argued that the relationship between CD and the use of majority-owned foreign subsidiary structures over non-majority owned structures will depend upon investment motive (Brouthers & Brouthers, 2003; Pan, 2017; Powell & Lim, 2017). For manufacturing investments, firms will be most concerned with *internal* uncertainty and costs, increasing the likelihood of majority-ownership to reduce or avoid uncertainty and costs that come with a culturally dissimilar host-country partner. Alternatively, for non-manufacturing investments, firms are most concerned with uncertainty and costs at the interface between a foreign subsidiary and the external host country market. Attention to external uncertainty and costs should decrease the likelihood of a majority-ownership foreign subsidiary structure, as local partners in a culturally dissimilar host-country can help to fill in knowledge gaps and decrease uncertainty and costs.

Research on investment motive identifies knowledge gaps as a key driver of uncertainty and costs, yet firms may fill these gaps through related experience, and we argue that the implications will be different depending upon investment motive. Specifically, we argue that related experience reduces the need to rely upon local partners to fill knowledge gaps in non-manufacturing investments, thereby positively moderating the relationship between CD and the use of majority-owned

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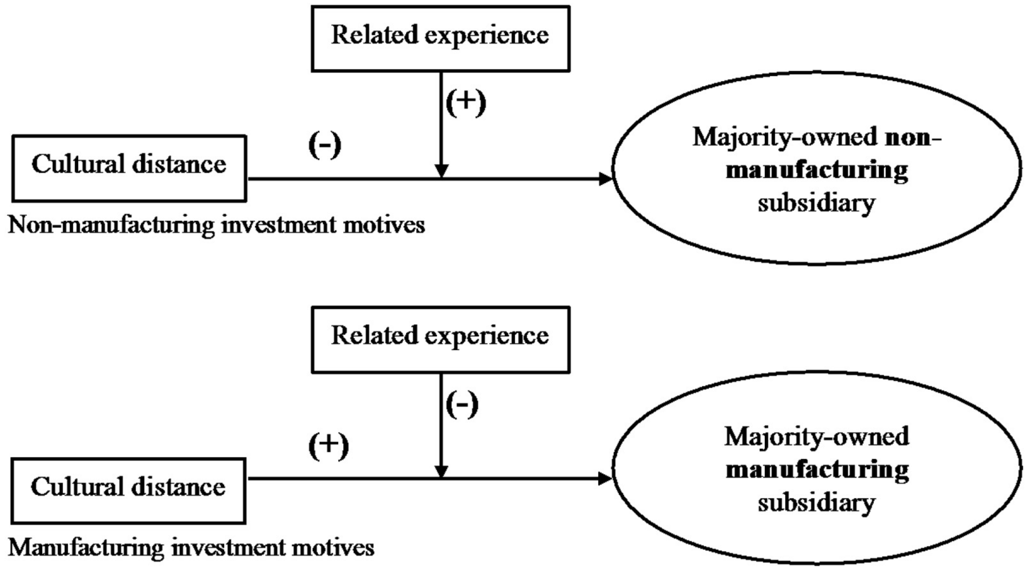

Fig. 1. Conceptual models depending upon investment motive.

foreign subsidiary structures. Alternatively, we argue that for manufacturing investments, related experience fills knowledge gaps and reduces the need to reduce internal uncertainty and costs through greater levels of control afforded by majority ownership, thereby negatively moderating the relationship between CD and the use of majority-owned foreign subsidiary structures. For clarity, these two differing expectations on the moderating role of related experience on CD and foreign subsidiary ownership structures, depending upon investment motive, are presented in the conceptual models in Fig. 1.

2. Theoretical development

2.1. Cultural distance and foreign subsidiary ownership structure relationships

Research has explored relationships between home- and host-country CD and foreign subsidiary ownership structures (e.g., Contractor, Lahiri, Elango, & Kundu, 2014; Kogut & Singh, 1988; Wang & Schaan, 2008). However, actual results have been mixed. The response to diverse findings in this area has been to explore potential relationships in different empirical contexts, or to explore potential moderators of CD and foreign subsidiary ownership structure relationships (e.g., Brouthers & Brouthers, 2001; Lopez-Duarte & Vidal-Suarez, 2013; Zhang, 2015).

It is not surprising that empirical results have been inconsistent, because theoretical expectations differ in the anticipated responses of firms when investing in culturally dissimilar host countries (Lopez-Duarte & Vidal-Suarez, 2013). One perspective notes that CD may initially mean that firms will face knowledge gaps in host countries. Specifically, firms embedded in different national cultural environments will have experiences that differ systematically as a function for their cultural environments (Hutzschenreuter & Matt, 2017; Powell & Lim, 2017), and these experiences lead to organizational knowledge, which is embedded in familiar and repeated routines and practices in an organization (Zollo & Winter, 2002). The development and accumulation of organizational knowledge can be conceptualized in terms of the development of organizational knowledge stocks (Hutzschenreuter & Matt, 2017; Powell & Rhee, 2016), and knowledge stocks allow firms to respond effectively to issues that are like those they have encountered before. However, knowledge stocks accumulated through operating in one cultural environment may not offer clear responses to issues encountered in another environment (Hutzschenreuter & Matt, 2017; Petersen, Pedersen, & Lyles, 2008). As a result, in culturally distant host countries, parent firms are likely to face gaps in their knowledge stocks, leading to an enhanced probability of failure (Johanson & Vahlne, 1977). This first theoretical perspective predicts that firms will respond to these gaps in knowledge stocks resulting from cultural differences by offering greater levels of control to local partners, whose knowledge stocks reflect the host country's cultural environment. By offering greater levels of control to local partners, often through greater levels of ownership in the subsidiary, parent firms may be able to overcome these gaps in their knowledge stocks (Anand & Delios, 1997; Kogut & Singh, 1988). A large portion of this research discusses this relationship in terms of uncertainty and costs (Erramilli & Rao, 1993; Gatignon & Anderson, 1988; Kim & Hwang, 1992; Kogut & Singh, 1988), rather than focusing on gaps in knowledge stocks as the antecedent to this uncertainty, but the implication is the same. This perspective anticipates a negative relationship between CD and greater levels of ownership in foreign subsidiaries.

An alternative perspective also emphasizes uncertainty and costs that result from gaps between a firm's knowledge stocks and the knowledge stocks required for successful operations in a culturally dissimilar host country. However, this perspective aligns more closely with research that focuses on internal transaction costs (e.g., Hennart, 1988), in that inefficiencies and the potential difficulty in monitoring partners in different cultures can be an argument for more fully internalizing operations, or reducing shared hierarchy with partners. For example, this approach notes that coordination between culturally dissimilar partners, and information sharing with these partners, is likely to be expensive (Hennart & Reddy, 1997; Li & Guisinger, 1992; Zhao, Luo, & Suh, 2004). Hence, if a firm more fully controls a foreign subsidiary, through greater levels of ownership in this case, then the firm will be reducing or eliminating the need to coordinate and share information with a culturally dissimilar partner or partners, effectively reducing these transaction costs (Hennart, 1989; Kim & Gray, 2009; Tsang, 2005). As with the first perspective, this second perspective seems sound and theoretically valid, but empirical results over the decades have not pointed to one clear winner in the sense that support has appeared for both predicted relationships in different empirical contexts.

2.2. The role of investment motive

International business and strategy researchers have long noted that