

Psychic Distance under Assimilation and Contrast Bias: A Directional Equivalence Approach

Abstract

Our paper focus on an examination of perceived psychic distance in the presence of two potential individual level biases — assimilation and contrast — associated with the levels of familiarity with a specific culture. We argue that psychic distance is not directionally equivalent and that these biases affect the decision-maker's perception of cultural differences. This bias leads to a difference between the individual perceptions of cultural differences and the actual cultural differences in the environment. The implications of this distinction on entry mode decisions is reviewed with four different cases considered: 1) higher control entry mode than appropriate; 2) lower control entry mode than appropriate; 3) high home country resistance; and 4) host country lack of opportunities. A theoretical framework is developed and research propositions are discussed in light of qualitative data collected through personal interviews with individuals from the United States, Brazil, Taiwan, and Singapore.

Keywords: Psychic Distance, Cultural Distance, Assimilation and Contrast Bias, Entry Mode, Qualitative Interviews

Introduction

It has been claimed that international business research is not complete without controlling for the effect of cultural distance (CD) (Cho and Padmanabhan, 2005), and the effect of cultural differences on business activities have been considered since Beckerman (1956) first discussed the concept. Cultural distance captures differences between the cultures of two different countries (Johnson, Lenartowicz, and Apud, 2006), and has been used to explain various international business activities including foreign market entry mode decisions (Cho and Padhmanabhan, 2005), differences in multinational performance in foreign markets (Gomez-Mejia and Palich, 1997; Morosini et al., 1998) , inter-firm cross-border knowledge transfer (Simonin, 1999; Minbaeva et al., 2003), expatriate adjustment (Black and Mendenhall, 1991), and patterns of foreign direct investment (Grosse and Trevino, 1996; Habib and Zurawicki, 2002).

While there are various potential measures of cultural distance, recent meta-analyses find that the one most commonly used is the composite index of Hofstede's (1980) cultural values proposed by Kogut and Singh (1988) (Tihanyi and Griffith, 2005; Magnusson, Baack, Zdravkovic, and Staub, 2006). This Euclidean distance measure operationalizes the CD between two countries and the ease with which it can be used has led to a body of research including CD as one of the explanatory variables (Harzing, 2004). Unfortunately, the ease of conceptualizing CD as a simple and standardized measure, such as the Kogut and Singh (1988) computation, can mask fundamental problems including unsupported and often hidden assumptions (Shenkar, 2001) and potential difficulties associated with the level of analysis (Dow and Karunaratna, 2006). This "blind confidence" in Kogut and Singh's (1988) index has been severely criticized (Shenkar, 2001; Harzing, 2004; Magnusson, et al., 2006)..

In response to these criticisms, recent research has focused on the difference between psychic and cultural distance measures (Sousa & Bradley, 2006), and has begun to take a broader and more individual based view of the effect of culture on international business (Dow and Karunaratna, 2006). This individual level of analysis moves beyond what has been called a “simplistic view of culture” (Leung, et al., 2005, pg. 374), and instead considers individual perception of cultural differences to be dynamic and influenced by contextual variables (Leung, et al., 2005; Kirkman, Lowe, and Gibson, 2006).

This paper adds to this growing psychic distance literature stream by drawing from the psychology literature two potential individual level biases that may affect psychic distance. These biases, assimilation and contrast, are based on levels of familiarity with cultures, a contextual variable and may result in a disconnect between individual perceptions of cultural risk and the actual risk in the environment. This flawed perception has important implications for various international business topics, but this paper will focus on the implication for entry mode decisions.

To explore these various international business issues, this paper is organized as follows. First, the importance of the cultural distance concept, especially in terms of internal risk or uncertainty, on the entry mode decision will be discussed, and the ambiguous empirical results regarding cultural distance will be reviewed. Second, recent criticisms of cultural distance and the Kogut and Singh’s (1988) computation will be discussed with a focus on the assumption of directional equivalence. Third, the cultural versus psychic distance distinction will be reviewed. Fourth, the concepts of assimilation and contrast bias will be introduced and applied to the prediction of cost and risk in the entry mode decision. A qualitative exploration of these biases

will be interwoven throughout the discussion. Based on these findings, and on the theoretical discussion preceding them, a series of propositions will be presented.

The underlying logic of this work is theory building (i.e., elaboration of constructs and propositions), which involves inducting insights from existing literature and field-based interviews. Using this logic, this paper contributes to the international business literature in several ways. First, the empirical findings of the effect of cultural distance and psychic distance on entry mode have often been conflicting and inconclusive (e.g., Tihanyi, Griffith, & Russell, 2005). While it is not assumed that all of these problems are a result of assimilation or contrast bias or level of analysis difficulties, a better understanding of potential biases and a shift of focus to individual decision makers may provide important insight into cultural based risk and entry mode decisions. Second, there is a growing body of literature criticizing cultural distance (e.g., Shenkar, 2001), and this study expands on these criticisms by exploring, both qualitatively and theoretically, the implication of these criticisms. Third, while the literature already acknowledges the lack of symmetry in the Kogut and Singh (1988) measure (Shenkar 2001), and already makes a distinction between national level (cultural distance) and individual level measures (psychic distance) (e.g., Dow and Karunaratna, 2006), the field is only beginning to explore the theoretical and empirical implications of these criticisms. For example, there is little qualitative research investigating psychic distance, and no studies empirically examining Shenkar's (2001) illusion of symmetry or applying the assimilation and contrast biases to the psychic distance concept. This paper begins to meet all of these research gaps and begins to take the more dynamic view of culture called for in recent writings (e.g., Leung, et al. 2005).

Criticisms of Culture Distance and Entry Mode Decisions

Entry mode refers to the choice of entry form made by multinational business decision makers when entering a foreign market. Entry mode types range from complete ownership to exporting with the typical theoretical trade-off being between level of ownership or control with the amount of risk involved. One of the dominant theoretical explanations of entry mode decisions is the transaction costs theory (Williamson, 1975). This theory is rooted in the attributes of transactions and in the bounded rationality and opportunism of human actors. Transaction costs theorists posit that cultural differences lead to increased information-gathering costs, increased difficulties in transferring competencies and skills, increased difficulty in forward thinking, and the end result of these difficulties is increased costs and risks (Williamson, 1975; Buckley and Casson, 1976; Anderson and Gatignon, 1986). In response to these increased costs and risks in culturally distant foreign markets, transaction costs theorists typically predict that the more culturally distant the country the lower control the entry mode (Kogut and Singh, 1988; Agarwal, 1994)

Despite this theoretical foundation, empirical research on cultural distance and entry mode choice has been inconclusive. Some studies find that as the cultural distance between countries increases, the level of ownership and control increases (Pan, 1996; Hennart and Reddy, 1997). Other studies conclude that the higher the cultural distance the greater the likelihood of joint ventures (Hennart & Larimo, 1998; Brouthers & Brouthers, 2001). Still other studies find that as cultural distance increases, firms are more likely to use low control modes such as licensing (Arora & Fosfuri, 2000) or lower percentages of equity ownership (Barkema, et al., 1997; Barkema and Vermeulen, 1998). Lastly, other studies do not find a relationship between cultural distance and control structure (Burton, et al., 2000; Li, et al., 2001). Recently completed

meta-analyses further muddle this discussion. Both Tihanyi et al.'s (2005) and Magnusson et al.'s (2006) meta-analyses conclude that cultural distance has a small negative effect on entry mode choice.

These inconclusive findings may be partially rooted in the measure of cultural distance typically used, namely Kogut and Singh's (1988) national level computation. Two contemporary meta-analyses find this measure to overwhelmingly be the typical measure and express concern that the field is overly reliant on the measure (Tihanyi et al., 2005; Magnusson, et al., 2006). This concern is partly rooted in Shenkar's 2001 Journal of International Business Studies article that pointedly criticizes the Kogut and Singh measure. In this paper, Shenkar focuses on various assumptions or illusions inherent in the Kogut and Singh (1988) computation. One of these illusions is the "Illusion of Symmetry." To quote:

"'Distance', by definition, is symmetric: the distance between from point A to point B is identical to the distance from point B to point A. CD symmetry is difficult to defend in the context of FDI. It suggests an identical role for the home and host cultures, for instance, that a Dutch firm investing in China is faced with the same CD as a Chinese firm investing in the Netherlands. There is no support for such an assumption . . . there are no studies showing symmetry between the two nor is there a reason to assume one" (pg. 523).

While Shenkar (2001) discusses the potential asymmetry in cultural distance, the article does not propose any drivers for this effect. This paper therefore builds on this "Illusion of Symmetry" concept by introducing applying two individual-level biases from the psychology literature. These biases, assimilation and contrast, are a potential driver of asymmetry and directional inequivalence.

One measure that moves beyond Kogut and Singh (1988) was introduced by Dow and Karunaratna (2006) and incorporates a range of potential psychic distance stimuli including differences in culture, language, religion, education, and political systems. The study finds that, whereas the majority of the proposed indicators prove to be statistically significant predictors of trade flows, Kogut and Singh's (1988) measure was not significant.

The inconclusive entry mode findings may also be driven by the level of analysis used. There has been a growing emphasis in the literature on a distinction between a national level, cultural distance measure and an individual level, psychic distance measure (Sousa and Bradley, 2005). There is statistical evidence of differences between individual and national level measures regarding the effect of culture on entry mode decisions (Drogendijk and Slangen, 2006). Recent writings have emphasized that research on the effect of culture differences on international business "should ideally be measured by the perceptions of the decision makers at the time the decision is made" (Dow and Karunaratna, 2006).

Therefore, this paper will consider how an individual level analysis of the entry mode decision opens the process to the potential for bias. As this paper looks at cultural differences at an individual level, for the rest of the paper the term psychic distance is used. Psychic distance is defined as "the mind's processing, in terms of perception and understanding, of cultural and business differences" (Evans, et al., 2000, p.375). This definition and the use of the term psychic distance shifts the focus away from distant, national level measures of cultural distance, to the more personal, individual level psychic distance measure. This focus on the individual, instead of on reductionist, national level values (Hofstede, 1980), allows for the research to begin exploring how individual level biases may influence the perception of culture based risk in entry mode decisions. Moreover, this paper distinguishes between the existing psychic distance in a cross-

cultural relationship and the perception, a potentially biased one, of that distance. This perception component of psychic distance is contained in the definition from Evans et al. (2000), but most writings on cultural differences focus on the national vs. individual-level distinction, failing to consider the role of faulty, individual level biases.

This paper introduces a pair of such biases – assimilation and contrast – to the discussion and explores through both theoretical discussion and a qualitative analysis, how these biases influence the perception of individual's from different cultures. These biases are drawn from social and cognitive psychology writings (e.g., Hart and Diehl, 1994). Assimilation is defined as “the perception of one's view being closer to another's view than they actually are” (Hart and Diehl, 1994, pp. 71). On the other hand, contrast bias is defined as “when a person holds a view relatively distant from another's” and states that this “person will likely perceive the opposing view as even more distant than it is in actuality” (Hart and Diehl, 1994, pp. 71). These psychological concepts have implications for the perception of psychic distance and for entry mode decisions. To this end, the paper develops a theoretical framework that incorporates assimilation and contrast bias into a discussion of entry mode decisions and, through this application, provide insight into the inconsistent empirical results regarding the effect of cultural differences on entry mode decisions.

Theoretical Framework and Research Propositions

The development of this paper's theoretical framework and propositions is guided by the culture and entry mode literatures in international business and by the psychology literature on assimilation and contrast. In addition, a series of interviews were completed with individuals with potential perceptual biases. For these preliminary interviews, three pairs of countries were

sampled: United States – Brazil, United States – Singapore, and United States - Taiwan. In each pair of countries individuals were identified that were representative of potential assimilation or contrast bias in relation to the other specified country. These respondents were either extremely familiar with or had very limited exposure to the paired country culture. In total 24 individuals were interviewed, with 12 potentially having an assimilation bias and 12 potentially having a contrast bias. These interviews provide preliminary insight into the relationships theoretically explored below, particularly on how assimilation and contrast biases affect individual level perception of psychic distance. While the results of the interviews are not testable, quotes from the interviews will be interspersed throughout the theoretical framework below to help support and illuminate the discussion.

Directional Equivalence

In Shenkar's (2001) article, the Kogut and Singh (1988) measure is criticized for an Illusion of Symmetry. In this paper, we apply this illusion to an individual level analysis and, as the level of analysis for this paper shifts to the individual, discuss it in terms of directional equivalence. The assumption of directional equivalence is based on the idea that the psychic distance between country A and B does not depend on which direction it is being observed. In other words, the distance between country A and B perceived by an individual in country A is assumed to be the same as the distance perceived by another individual in country B. Because of the potential for differences and biases in individual perceptions, we can not assume that psychic distance is directionally equivalent. Consider the hypothetical example of a Brazilian, the son of Japanese immigrants but born in the Japanese section of Sao Paulo, raised in Brazil but with predominantly the same values and behavior patterns as his Japanese parents. This Japanese-

Brazilian is making an entry mode decision for a Brazilian firm entering Japan. Compare the potential psychic distance for this manager with the psychic distance for a Japanese citizen who knows Brazil only from hearing about Carnival, and maybe the soccer player Pele. Obviously, the directional equivalence assumption does not hold.

The theory of assimilation and contrast (Hart and Diehl, 1994), which suggests that individuals react differently to the same message, depending on the degree of similarity or difference perceived in relation to the originator of the message, provides further support for a lack of directional equivalence. Our interviews provide anecdotal evidence of a lack of directional equivalence. Consider the difference in responses between an American respondent highly familiar with Singapore culture with the responses of a Singaporean unfamiliar with the United States. The American respondent comments that “Singapore is the most Western influenced Asian country. The opportunity for conflict is very low due to the trade and economic relationship that the two countries share. In addition, Singapore has long been an ally and a stable Asian country for the US to leverage. The USA will look to countries like Singapore to continue to push democracy in the region. The economic and political needs will limit conflict.” In comparison, a low familiarity, contrast bias Singaporean respondent said that Americans have: “less hesitation in expressing how one feels; either pleasure or unhappiness. Use more words to communicate by explaining at length. More liberal in terms of values to live by. Greater sense of self rather than community – emphasis on “I.” In terms of communication, Singaporeans may find someone from the United States more opinionated and assertive. Singaporeans may also regard them to have more self interest with less regard for group’s harmony and disrupting the equilibrium within the group.”

These quotes support the above theoretical discussion, and provide further evidence against the assumption of directional equivalence. The American respondent assumes far fewer cultural differences and for lower potential for cultural conflict than the Singaporean respondent. Therefore, based on the above discussion and interview evidence, we propose the following :

P1: Ceteris paribus, the psychic distance between countries A and B will lack directional equivalence. Therefore, there will be significant differences between the perceived psychic distance between countries A and B as perceived by individuals from country A, and the perceived psychic distance between countries B and A as perceived by individuals from country B.

Assimilation and Contrast Biases

Research suggests that the assimilation effect or bias will be present when the sender of the message shares something in common with the audience (for example, perspectives, values, race, life style, religion, faith, and other cultural characteristics) (Hart and Diehl, 1994). Due to this sense of familiarity, the individual will perceive the messenger as more of an equal, as more trustworthy, and the messenger's point of view will be more easily assimilated (Hart and Diehl, 1994). Alternatively, the contrast effect or bias is the tendency to exaggerate the discrepancies between the attitudes of an individual and the attitudes represented by the opinion of other people with opposite perspectives and ideas (Dawes, Singer, and Lemons, 1972). In other words, when an individual does not have a sense of familiarity and "has been exposed to different ideas" the individual will tend to exaggerate the actual differences between themselves and the messenger (Dawes, et al., 1972; Hart and Diehl, 1994).

While the origins of these effects are in the psychology literature, the biases have been applied to various business issues including the evaluation of brand alliances (Levin, 2002), print advertising (Yi, 1990; Schmitt, 1994), salespeople (Stafford, Leigh, and Martin, 1995), and individual performance (Ivancevich, 1983). The literature has found a consistent negative effect from these biases, and, for the contrast bias, it has been linked to an increase in conflict between groups, a skewed perception of the ability to compromise, and lower esteem for the other group or individual. This lowering of esteem in turn increases the contrast effect, making the bias self-perpetuating (Dawes, et al., 1972). The effect is also driven by pre-existing expectations or knowledge (Geers and Lassiter, 2005).

Therefore, as the level of familiarity that individuals have with a country's culture is not homogeneous, each individual is biased to some degree in relation to that country. Depending on the degree and type of individual bias (e.g., assimilation or contrast) each individual perceives the psychic distance in the relationship differently. Our interviews provide examples of this difference in familiarity. For our low familiarity, contrast respondents, there was frequently hesitation to respond and questions regarding their appropriateness as a respondent. One American respondent even stated that "I know nothing about Taiwan." This difference in familiarity was then reflected in the responses given. For example, the reluctant, contrast biased American respondent mentioned above that "While both the U.S. and Taiwan are developed, modern nations with democratic forms of government, I'd assume that nearly all other cultural features are different." In comparison, the assimilation American respondent, who had high levels of familiarity with Taiwanese culture, stated that "I think of any industrialized country as a country with westernized culture. I'm not sure that there are many significant differences in countries with westernized ideals." These two quotes, by individual from the same national

culture, but with vast differences in familiarity with Taiwanese culture, reflect how this familiarity can lead to bias. Therefore, based on our theoretical discussion and the anecdotal evidence from our interviews, we argue that assimilation and contrast biases will prejudice perceived psychic distance, and we suggest the following propositions:

P2: *Ceteris paribus*, in the context of assimilation bias, i.e., in cases where individual A has a high level of familiarity with the home country of individual B, the perceived psychic distance between countries A and B, as perceived by individual A, will be lower than the actual cultural differences between the countries..

P3: *Ceteris paribus*, in the context of contrast bias, i.e., in cases where individual A has a low level of familiarity with the home country of individual B, the perceived psychic distance between countries A and B, as perceived by individual A, will be greater than the actual cultural differences between the countries..

The above mentioned discussion and propositions assess the skewing effect of assimilation or contrast bias in perception of psychic distance between individuals from two countries. It is also important is for us to examine the combined effect of individual biases, and how this may affect the relationship between actual and perceived psychic distance. Research finds that the assimilation and contrast biases are more pronounced as the differences between the individuals become more extreme (Hart and Diehl, 1994). Moreover, the effects are found to be self-perpetuating and recursive (Dawes, et al., 1972). Therefore, in cases of duplicate bias, either bi-lateral assimilation or contrast, the pairing of like biased individuals will exacerbate the prejudice, and the perceived psychic distance will be more biased.

Our interviews provide some insight into how bi-lateral contrast or assimilation may increase cultural conflict. Consider the responses of two Brazilians unfamiliar with America, when asked about differences between the countries. The first states that “Americans are cold regarding personal relationships. They put too much value / emphasis on work to the detriment of other personal aspects of life. . . Americans have little flexibility.” The second respondent showed even more of a conflict bias, claiming that “Americans are more nationalistic. They think that everything that relates to US is bigger and better. US have a very aggressive capitalism, where everyone is obsessed about making money.” In isolation, these two Brazilian respondents see a large cultural gap and this potential contrast bias will, alone, increase the perceived psychic distance in the relationship, but consider how the amount of conflict in the relationship would be increased if they were in a business relationship with the American who was unfamiliar with Brazilian culture and wrote: “US – democratic, free market place, multicultural, multi-religious, generally middle class financially. Brazil – dictatorship, militaristic, mostly Catholic, not free, dangerous surroundings, generally lower class financially.” The cultural conflict in the pairing would obviously be higher than it would be with the American who was more familiar with Brazilian culture and responded that “Brazilians are more flexible regarding time and also very friendly. They are very hard working people but they also separate well work and family time. I believe we share a lot of the same values considering both countries are majority Christians.” Comparing the potential conflict with these pairings help illuminate how the assimilation and contrast bias do not operate in isolation and if paired together can compound the bias. Therefore, we suggest the following propositions:

P4: Ceteris paribus, in the context of bi-lateral assimilation bias where individuals A and B both have assimilation bias, the perceived psychic distance between countries A and B, as perceived by individual A, will be far smaller than cultural differences between the countries.

P5: Ceteris paribus, in the context of bi-lateral contrast bias where individuals A and B both have contrast bias, the perceived psychic distance between countries A and B, as perceived by individual A, will be far greater than the actual cultural differences between the countries.

Entry Mode Implications

A biased perception of cultural differences, whether assimilation or contrast, results in an overly optimistic or pessimistic estimation of the effect of these differences on business actions. This faulty perception is a result of a difference between the perceived psychic distance in a relationship and the actual cultural differences between the countries. While this bias may be important to many different aspects of international business, this paper focuses on how biased perceptions skew the estimation of the cultural biased risk and costs involved in entry mode decisions.

Our discussion of the entry mode decision is rooted in the transaction costs theory of the firm. In brief, this theory sees the firm's entry mode decision as a balance between the increased control that comes from internalizing the market and the increased costs and risks associated with that internalization. While the market should be the default choice, market inefficiencies and the resultant increase in costs produce a need for hierarchy or internalization (Anderson and

Gatignon, 1986; Erramilli and Rao, 1993). The focus of the theory is then on decreasing the costs, both ex ante and post, of the transaction through the choice of the most efficient entry mode (Hill and Kim, 1988). While a variety of factors influence these costs including bounded rationality and opportunism (Pak and Park, 2004), free-riding (Hennart, 1991), transaction-specific assets (Erramilli and Rao, 1993), and external and internal uncertainty (Anderson and Gatignon, 1986), this paper focuses on the increased risks and costs caused by cultural differences.

The transaction costs perspective sees increased psychic distance as a source of increasing risks and costs (Anderson and Gatignon, 1986). This growth in costs includes increases in communication costs (Pak and Park, 2004), knowledge transfer and knowledge acquisition costs, and the costs associated with the need for more knowledge (Gatignon and Anderson, 1988; Kim and Hill, 1988). Additionally, the price of monitoring and evaluating employees increases as does the cost of evaluating inputs and results (Erramilli and Rao, 1993). In general, the greater the psychic distance between countries, the higher are the transaction costs. Psychic distance not only increases costs but is a core component of the total risk companies face when entering a country (Brouthers, 1995). This increased risk is rooted in an increase in the potential for conflict (Kogut and Singh, 1988) and an increase in the chance of entry failure (Barkema, Bell, and Pennings, 1996).

While past studies have discussed psychic distance theoretical, only a few have discussed the potential for a difference between the perception by individuals of the differences between cultures and the actual, existing differences between these cultures. Gatignon and Anderson (1988) mention that increased cultural distance leads to an undervaluing of foreign investments, implying a disconnect between perception and reality. More pointedly, Kogut and Singh (1988)

refer to managerial perceptions of cultural differences and state that the increased costs from greater cultural distance “may be perceptual only or accurate appraisals of the increased difficulties of managing a foreign workforce in a culturally distant country” (p. 415). Therefore, this distinction between perceived and actual psychic distance has been hinted at in previous writings, but this is the first attempt to investigate potential causes of this difference.

Overall, transaction costs theorists predict that in response to the increased risk and cost caused by increase psychic distance, a low control entry mode should be selected (Kogut and Singh, 1988; Agarwal, 1994; Kim and Hwang, 1992; Pak and Park, 2004), though research over the last two decades has failed to consistently support this relationship (see Pan, 1996; Hennart and Reddy, 1997; Erramilli and Rao, 1993; Gatignon and Anderson, 1988).

How then will assimilation and contrast biases affect the theoretical relationships discussed above? In general, the biases result in managers having a skewed estimate of the costs and risks caused by psychic distance. In the case of assimilation bias, individuals will perceive the psychic distance, and its associated risks and costs as smaller than the actual psychic distance, resulting in a decision to use a higher control entry mode than appropriate. In the case of contrast bias, the individuals will perceive the psychic distance as greater than the actual psychic distance, resulting in a lower control entry mode than appropriate.

In the case of entry mode decisions, there are, in broad terms, two actors or groups of actors, involved in the decision – those from the host country and those from the home country. Each of these actors has different levels of familiarity with the home or host country culture, and, as such, will have either a contrast or assimilation bias. As shown in Figure 1, these different bias pairings will have important and different effects on the entry mode decision. As mentioned earlier, the assimilation or contrast bias in a transaction happens at the individual or group level,

and considering the existence of directional inequivalenc when these effects are present, we discuss the entry mode implications under four possible bias combinations: lower control then appropriate, higher control then appropriate, high home country resistance, and lack of host country opportunities.

The tendency to mistakenly choose a higher control entry mode then is appropriate will occur under conditions of bi-lateral assimilation, where both decision makers (home and host countries) are under the effect of assimilation bias. In this case the decision maker from the home country may underestimate the risks involved and became overly optimistic, reducing his/her capacity to rationally evaluate uncertainty and the corresponding costs, therefore, favoring the choice of an entry mode with higher levels of control when maybe a lower level of control would be appropriate. Therefore, we propose:.

P6: *Ceteris paribus*, in an environment of bi-lateral assimilation bias, managers will chose an inappropriately high control entry mode.

Under conditions of bi-lateral contrast there is a tendency to mistakenly choose a lower control entry mode to than is appropriate since both decision makers (home and host countries) are under the effect of contrast bias. This bias leads to an increase in the perceived, but not actual, psychic distance. In this case, the decision maker from the home country may overestimate the risks involved and became overly pessimistic, reducing his/her capacity to rationally evaluate uncertainty and costs, therefore, favoring the choice of an entry mode with lower levels of control than appropriate. Therefore, we propose:

P7: *Ceteris paribus*, in an environment of bi-lateral contrast bias, managers will chose an inappropriately low control entry mode.

High resistance will occur when the home country decision maker is under the effect of contrast bias and the host country decision maker is under the effect of assimilation bias. Even though the host country decision maker will be interested in a relationship, the home country decision maker would have a tendency to ignore the host's interest and be reluctant to enter the market. Additionally, the home market decision maker will push for a lower control entry mode than appropriate. Therefore we propose:

P8: *Ceteris paribus*, in an environment of home country contrast bias and host country assimilation bias, host country managers will face high resistance to market entry and home country managers will chose an inappropriately low control entry mode.

A lack of opportunities will occur in the case where the home country decision maker is under the effect of assimilation bias and the host country decision maker is under the effect of contrast bias. Due to the differences in perceptions of psychic distance, the home country decision maker will seek a higher control entry mode than appropriate while the host country decision maker will try to get all possible safe-guards, raising the transaction costs, and making the negotiation process more difficult. Therefore, we propose:

P9: Ceteris paribus, in an environment of home country assimilation bias and host country contrast bias, home country managers will face a lack of opportunity to enter the host country market and will choose an inappropriately high control entry mode.

The end result of these biases on the entry mode decision will be an increase in costs and an increase in chance of failure for the entry. These negative results will then result in poor subsidiary performance. This findings has been partially discussed previously in writings discussing the psychic distance paradox. In the classic article on this process, O'Grady and Lange (1996) found that Canadian firms entering the American market had high failure rates due to unanticipated cultural problems. Evans and Mavondo (2002) also found empirical support for the psychic distance paradox, reporting that Australian retailers performed better in psychically distant markets than in close markets. Similarly, Pedersen and Petersen (2004) observed firms experiencing a shock effect arising from unanticipated cultural differences in geographically close markets. The results of all of these studies point to a possible link between assimilation and contrast bias and performance. Therefore, we propose:

P10: Ceteris paribus, as contrast or assimilation bias increases, subsidiary performance will decrease.

Discussion and Implications

In this paper, we examined psychic distance in the context of assimilation and contrast bias as it relates to individual perception, and the effect of these biases on the perception of risk and costs for foreign market entry decisions. Overall, our theoretical framework and research

propositions suggest that psychic distance is not directionally equivalent, that there is a separation between the actual and the perception of psychic distance by decision-makers, that one source of this disconnect is assimilation or contrast bias, and that these biases affect entry mode decisions. Our support for these arguments is based on a review of the international management literature as it relates to cultural distance, transaction cost theory, and entry mode selection, and a bridging of this literature with the psychology literature on assimilation and contrast bias. To provide additional support for our discussion, the responses from preliminary qualitative data collected through personal interviews conducted with individuals in four countries: United States, Brazil, Taiwan, and Singapore are used.

Our interviews affirm the importance of considering the bias of the individual decision maker when dealing with international business issues and suggests that the type and the level of individual bias can affect the perceived psychic distance expected by the decision maker in cross country issues. Again comparing the responses between assimilated and contrast biased individuals, in this case two respondents discussing the potential for cultural conflict between Taiwan and the United States, their statements affirm the potential importance of these biases. The assimilation biased Taiwanese respondent states that “I have not found much cultural conflicts between the two countries. Taiwanese people have been assimilated by American culture in the sense that Taiwanese are quite receptive towards American culture.” In comparison, the contrast biased Taiwanese respondent states that “I think there are some conflicts between members of these two cultures. Because of different cultures, people hardly understand each other’s culture.”

Overall, our interview results suggest that it is important to consider the individual bias of the decision maker in the context of doing business in foreign markets. Our theoretical

framework, along with our preliminary qualitative data, supports the idea that individuals under conditions of assimilations bias due to familiarity, and the resulting perceived similarities with regards to the other culture, will be more open and willing to engage in business transactions with individuals from that culture. Moreover, the prior experience and exposure of the decision maker to the other culture will create a sense of familiarity that will in turn be associated with an overly optimistic assessment of the cultural differences or psychic distance involved. This is in line with Lunchins and Lunchin's (1985) statement that individuals initially committed to their positions may not be strongly committed when they perceive themselves as having moderate and conventional points of views about a certain issue and have assimilation bias towards the other culture. In turn, those holding extreme points of view as in contrast bias may be more committed and resistant to change. This potential increase in cultural friction then leads to a central argument of our paper, namely that assimilation and contrast bias can cause the decision maker to be either overly optimistic or pessimistic regarding the amount of risk or costs in a foreign market. This potential incorrect estimation will affect the desired level of control when entering the market and, therefore, result in the incorrect type of entry mode being selected.

Our proposed framework contributes to the international business field by extending research exploring the role of cultural differences in the entry mode process (Buckley and Casson, 1976; Anderson and Gatignon, 1986). In addition, it provides an opportunity to explore the relationship between psychic distance and cultural risk in the international business environment under conditions of assimilation and contrast bias. Insights from our preliminary interviews suggest that assimilation and contrast bias are important drivers of directional inequivalence and must be incorporated into studies of psychic distance.

Our findings and insights should help both researchers and practitioners understand the trends in psychic distance research and international business research in general. Our fieldwork seems to support our proposition that psychic distance is not directionally equivalent and the relationship between perceived psychic distance and the adoption of the appropriate entry mode is mediated by the level and type of individual biases in the transaction. Taking the transaction cost perspective as the basis we can then analyze how assimilation and contrast biases may influence the decision maker perception of cultural risk in conjunction with the choice of the appropriate entry mode. This insight into the entry mode decision may begin to partially explain the inconclusive empirical results regarding entry mode decisions and cultural distance (Pan, 1996; Hennart and Reddy, 1997; Eramilli and Rao, 1993; Gatignon and Anderson, 1988). Therefore, future research on the topic should consider the theoretical framework presented here within the context of potential asymmetry in cultural distance (Shenkar, 2001), the potential drivers of directional inequivalence, including assimilation and contrast bias, and the negative effect that the difference between perceived and actual psychic distance may have on entry mode choices and the subsequent performance of subsidiaries.

Additionally, this paper contributes to the international business field by contributing to the extant literature (Shenkar, 2001; Dow and Karunaratna, 2006) by emphasizing perceived psychic distance as a key construct in international business research and incorporating the concept of “illusion of symmetry” and other criticisms of the Kogut and Singh (1988) computation. Compared to previous work on the topic, our research is unique in that it focuses on individual perception and that it takes a qualitative, in-depth view of psychic distance. This qualitative approach is rare in the field. Finally, following Eisenhardt (1989) and Yin (1984), we defined our constructs and research question a priori to facilitate the initial design of our theory

building research. The research question was defined within the context of international business to examine how psychic distance under conditions of assimilation and contrast bias impact the decision maker choice of entry mode.

Our discussion also has interesting implications for international business education. Many curriculum focus on increasing cross-cultural awareness, and recent academic articles have begun to consider the possible negative or positive effect of this increased cross-cultural competence (Johnson, et al., 2006, Magnusson, et al., 2006). This study presents the possibility that increased familiarity with a culture will lead to assimilation bias and its corresponding faulty decision making. Identification and education regarding this bias is the simplest way to avoid this problem. International business educators need to be certain to distinguish between knowledge and deep understanding and to limit the overconfidence of students.

Our study has several limitations. First, our theoretical model was developed through a review of existing literature and supported by qualitative data from only 24 individuals from 4 different countries. Since data based on a large sample have not yet been collected for testing our framework, we should be cautious in drawing conclusions outside the untested propositions presented here. Second, we must be careful in generalizing our findings since we did not have large number of observations representative of a large population to confirm our propositions. According to Diesing (1971) a sequence of cases would be needed to provide support and confirm our propositions. Unfortunately, our method did not allow us to fully compare how consistently similar the cases may be, or the ways that they are not similar. Therefore, we cannot fully disregard potential selection bias, survivor bias, or other results of idiosyncrasy. Although we believe our findings could be generalizable outside these four countries, we must recognize that there is the possibility that these four countries could turn out to be special cases due to

exogenous variables that are not considered in the study. Future research that collects data in a large number of different countries and empirically tests this model using a large-scaled survey is warranted.

In addition to addressing the limitations of our study, there are several promising avenues for future research. For simplicity, our theoretical framework is talking about individuals, but the contrast and assimilation effects have also been found to influence group behavior (Hart and Diehl, 1994). Moreover, the entry mode decision may be made by a group or groups, not by a simple pairing of individuals from two different countries. The consideration of these groups dynamics was avoided in this paper, and is a potential avenue for future writing. In addition, Leung et. al. (2005) suggested that: “experimentation provides a powerful tool for probing causal relationships” (p. 375) and that culture is a topic that lends itself well to exploration using experimentation methods. Therefore, future research could test our framework experimentally. Our discussion purposefully takes a traditional view of the transaction costs theory of the firm. By doing so, we do not consider the effect of assimilation and contrast bias on other forms of control, such as trust and bargaining power (Gao, 2004). We also do not address evidence that cultural differences are a more significant problem for joint ventures than for other modes (Barkema, et al., 1996). Lastly, our propositions and discussion hold all other transaction cost variables constant, but there is discussion in the literature of an interaction between other variables, especially asset specificity, and the effect of cultural distance on entry mode choice (Andersong and Gatignon, 1986). We leave it to future research to investigate these issues.

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CONTRAST

Figure 1: Perceived Psychic Distance under conditions of Assimilation and Contrast Bias

		HOST COUNTRY	
		ASSIMILATION	CONTRAST
HOME COUNTRY	ASSIMILATION	Higher control entry mode than appropriate	Lack of host country opportunities
	CONTRAST	High home country resistance	Lower control entry mode than appropriate