

WHY THE DISTANCE LITERATURE IN MANAGEMENT IS ABOUT INSTITUTIONS, NOT DISTANCE, AND WHAT TO DO ABOUT IT

Abstract

We theoretically identify and empirically demonstrate a vital hitherto neglected design flaw that invalidates almost all of the distance research in management that has been done so far. The root of the flaw is that, when keeping the base (home or host) country fixed, differences in institutional distance between the various partner countries and the base country collapse into measures of the institutional profiles of these partner countries. Implication is that analyses examining the effect of institutional distance between one base country and various partner countries on such issues as foreign market entry mode or market selection conflate the effect of distance with the effect of these partner countries' institutions. Quantitatively, the problem is most severe for base countries with an institutional profile at the extreme of the distribution, notably the US. Empirical analyses of institutional distance and its effect on international management phenomena are only valid when they consider multiple base countries sampled from across the distribution of institutional profiles simultaneously.

Keywords: distance; institutional distance; cultural distance; Kogut-Singh index; home country; host country; institutional profile

INTRODUCTION

Whenever firms go abroad, they are confronted with distance. Doing business internationally implies having to manage operations in environments that are both far away and different from one's own (Zaheer, Schomaker, & Nachum, 2012). This feature of international management brings about difficulties and costs. Examples include transport and coordination costs, uncertainty due to lack of knowledge of the environment, and lack of legitimacy. Together, the challenges posed by operating in distant contexts are summarized under the header of "liability of foreignness" (Bae & Salomon, 2010; Eden & Miller, 2004; Hymer, 1976; Miller & Eden, 2006; Zaheer, 1995). Because of this liability, managers need to heed the "law of distance:" the intensity of global business interactions is affected by distance (Ghemawat, 2001, 2011).

A substantial body of research exists that examines this effect of distance and the associated liability of foreignness on foreign direct investment decisions concerning location choice and preferred entry mode (Barkema, Bell, & Pennings, 1996; Galan, González-Benito, & Zuñiga-Vincente, 2007; Kogut & Singh, 1988), but also on other issues in international management such as subsidiary performance and joint venture success (Krishnan, Martin, & Noorderhaven, 2006; Luo & Park, 2001; Pothukuchi, Damanpour, Choi, Chen, & Park, 2002). Distance in this context is not only seen in geographical terms, but, especially, as institutional distance, a broad term covering both differences in regulatory, political or economic, formal institutions and differences in informal norms, values, beliefs and shared cognitive structures (Bae & Salomon 2010; Berry, Guillén, & Zhou, 2010; Kostova, 1999; Kostova & Zaheer, 1999; Xu & Shenkar, 2002). A popular distance framework is that of Ghemawat (2001), identifying

four types, of distance: Cultural (C), Administrative (A), Geographical (G), and Economic (E), which Ghemawat abbreviates into CAGE.

The importance of institutional dimensions of distance as a source of liabilities notwithstanding, the application of the distance metaphor is not without its problems. Specifically, we find that the literature on the effects of cross-national distance suffers from a conflation between the concepts of institutional distance and institutional profile. Institutional profile is a characteristic of a home or host country; it refers to the home or host country's score on a set of institutional indicators such as culture, economic profile, or administration (Busenitz, Gomez, & Spencer, 2000; Kostova, 1997). Institutional distance is a characteristic of the relation between home and host country; it concerns the extent to which the institutional profiles of the two countries are similar or different.

In practice, most distance research focuses on distance either to or from one base country. Statistical agencies have gathered a great deal of data for on the US so often the US acts as base country in distance studies. By thus keeping one country fixed, however, the measure of institutional distance collapses into a measure of the institutions of the partner countries alone. Mathematically, we take the scores of different partner countries' on a set of institutional indicators, from which we repeatedly subtract the same constant, namely the base country's score on the same set of institutional indicators. The result is that, in all cases, the only source of variation in distance is the variation in the scores of these partner countries on the institutional indicators themselves. Therefore, it is impossible to distinguish any effect of institutional distance from a direct effect of partner countries' institutional profiles. Do US firms prefer a particular entry mode in China because, say, China scores so *low* on individualism or because

China scores so *differently* on individualism than the US does? Only the latter rationale would be a genuine distance effect (in this case of cultural distance) but not the former.

Why does the distinction between institutional distance and institutional profile matter? In international management, there is considerable attention for so-called closing mechanisms (Shenkar, 2001), efforts that reduce or help managers overcome institutional distance. An extensive literature exists on, for instance, cultural sensitivity of managers and how to achieve it (e.g., Earley & Mosakowski, 2004). However, such efforts to reduce distance will have no effect if the actual liability lies in the partner country's institutional profile, for instance weak rule of law, rather than with institutional distance per se. If an affiliate from a US firm is underperforming because it is embedded in a local culture of corruption, cultural sensitivity training of managers will do nothing to solve this problem. It is therefore paramount to distinguish between the effects of institutional distance and of institutional profile.

Building our case involves two steps. In the next section we first explain why and to what extent institutional distance analyses that use only one base country tend to conflate distance with institutions. Moreover, we argue that, because of its specific position on most institutional dimensions, the US is likely to be a particularly problematic base country in empirical analyses of the effect of institutional distance on issues in international management. We then provide an empirical demonstration of the problem that we identified theoretically for institutional distances in the area of culture and administration (cf. Ghemawat, 2001). This empirical analysis shows that cultural and administrative distance scores correlate highly with the country scores on the underlying indicators of culture and administration. We limit our empirical demonstration to a small set of base countries that is commonly used in distance studies. In line with predictions, the correlation between distance and partner country institutional profile is particularly high in cases

where the US acts as base country. The conclusion following this analysis is that institutional distance studies considering only one base country are indeed invalid. Not all is bad, however. Knowing the mechanism that causes measures of institutional distance to collapse into measures of institutional profile, we can spell out in a precise manner how cross-national distance studies need to be redesigned to solve for the problem that we identified. Theoretically, a solution can come from including multiple base countries, drawn from across the distribution of institutional profiles, as we discuss in the third section. We then use empirical analysis to show how much difference a relatively straightforward redesign of distance studies can make on the extent to which institutional distance and institutional profile are correlated. We end this paper with some concluding remarks.

INSTITUTIONS, NOT DISTANCE

Distance is perhaps the defining concept of international management (Xu & Shenkar, 2002; Zaheer et al., 2012). What sets international management research apart from management studies in general is an interest in the impact of cross-national distance on the behavior of firms. Institutional distance here is understood as a multi-faceted concept, covering differences in diverse areas such as economic conditions, quality of government, language, or religion (Bae & Salomon, 2010; Beckerman, 1956; Berry et al., 2010; Campbell, Eden, & Miller, 2012; Dow, 2000; Hewett, Roth, & Roth, 2003). One of the most researched dimensions of institutional distance in international management, however, is so called cultural distance, which is usually measured through the well-known Kogut-Singh (1988, p. 422) formula (Bae & Salomon, 2010;

Berry et al., 2010; Drogendijk & Zander, 2010; Em, 2011; Shenkar, 2001). This formula reads as follows:

$$CD_j = \sum_{i=1}^4 \left\{ (I_{ij} - I_{ib})^2 / V_i \right\} / 4. \quad (1)$$

In this formula, CD_j is the cultural distance of the j th country from a base country denoted by b , I_{ij} indicates the national culture score on the i th dimension of country j , and V_i is the variance in country scores on cultural dimension i . Hence, the formula presents the cultural distance between base country b and partner country j as the sum of squared differences between country b 's cultural dimension scores and those of the partner country, corrected for differences in the variances of each dimension. Finally, the number four in the formula reflects that the Kogut-Singh formula is meant to be comprehensive and collapses distance scores on Hofstede's (1980) four original dimensions (Individualism, Power Distance, Uncertainty Avoidance, and Masculinity/Femininity) into a single index. Only very few studies expand on Kogut and Singh's (1988) original measure to include the dimensions of Long-Term Orientation or Indulgence versus Restraint that Hofstede added to his framework after follow-up research (e.g. Hofstede, Hofstede, & Minkov, 2010). Other measures of institutional distance have been constructed in similar ways. Country scores on an indicator of political or regulatory quality, such as the Kaufmann-index (Kaufmann, Kraay, & Zoido-Lobaton, 1999), the Global Competiveness Report, or the International Country Risk Guide are taken and subtracted from each other (e.g., Gaur & Lu, 2007; Wan & Hoskisson, 2003). There is no universal or generally accepted way of operationalizing institutional distance. Berry et al. (2010) review empirical indicators used in the literature to capture different dimensions of institutional distance, finding a large variety of

potential indicators, and proposing their own broad index. In practice, measures of institutional distance often have strong overlap with Ghemawat's (2001) CAGE framework, except of course for geographical distance (G).

A detailed look at several surveys of research examining institutional distance (Bae & Salomon, 2010; Em, 2011; Kirkman, Lowe, & Gibson, 2006) reveals that a large majority of these only consider either one home or one host country. They are what we may call 1,N or M,1 cultural distance studies, where the first number (1 or M) refers to the total number of home countries in the analysis and the second number (N or 1) to the total number of host countries. As mentioned, in most of these studies the base country chosen is the US. China is also popular (e.g., Luo, 2001; Luo & Park, 2001; Pan, 1996) but considered much less often than the US.

For 1,N or M,1 studies, the distance on each administrative or cultural dimension included in a study's measure can be graphically depicted by means of Figure 1. Figure 1 considers one base country (which, as indicated, can act as either the home or the host country) and three partner countries. The partner countries vary with regard to their scores on institutional indicator i (say the cultural dimension of Individualism), while the distance between the base country and the various partner countries is given by the differences between base country position b and partner country positions x , y , and z . What is important to note, is that the base country position b , from which scores x , y , and z are subtracted to calculate distance, is a factor that is equal for all partner countries. As Figure 1 illustrates, the result is that the variation in distance within the set of partner countries is entirely proportional to the variation in the institutional indicator score of the partner countries. Stated differently, if we would include this distance measure in a regression analysis, the b of the base country would end up in the constant, and the estimated coefficient for the effect of distance on the management phenomenon of

interest will be a perfect reflection of the effect of partner countries' scores on the institutional indicator i . Fundamental implication is that, in cases with a single fixed base country, it becomes impossible to distinguish between the effect of distance and the effect of partner country score on the institutional indicator of interest.

 Insert Figure 1 about here

Two features of institutional distance indexes, such as the Kogut-Singh operationalization, could provide a countervailing power against this argument. For the simple case depicted in Figure 1, institutional distance scores and institutional indicator scores are clearly equivalent. Equivalence becomes less obvious if we calculate the distance between countries using several indicators together rather than only one indicator. Considering more than one indicator of institutional distance simultaneously is common in management studies (Berry et al., 2010; Brouthers, 2002; Evans & Mavondo, 2002; Gaur, Delios, & Singh, 2007; Kostova and Zaheer, 1999; Wan & Hoskisson, 2003). By summing over multiple indicators, Kogut-Singh-type distance indexes take such aggregation a step further, combining separate features of countries' institutional profiles in a single composite measure. Logically, such a composite measure will not correlate as strongly with any of the underlying institutional indicators as measures of distance based on separate institutional indicators will. The effect of combining multiple indicators is likely to be strong enough to cause a structural difference between partner

country scores on each separate institutional indicator and distance measured by this composite index.

Compared to the situation in Figure 1, equivalence is also less obvious if we move to a situation in which some partner countries score higher on the institutional indicator than the base country, while others score lower (Figure 2). Since there is no such thing as negative distance, distances are usually taken as absolute scores of differences in countries' indicator scores (or squared in the Kogut-Singh formula). Both a partner country scoring two points higher and a partner country scoring two points lower than the base country have a distance of two to the base country. As a result, institutional distance to partner countries and institutional profile of partner countries can, in principle, become separate things. In Figure 2, Partner Country 3, for instance, scores higher on the indicator in use than Partner Country 1 ($z > x$), but the distance of Partner Country 3 to the base country is smaller than that of Partner Country 1 ($|z-b| < |x-b|$). In terms of variation, in this case it is no longer a given that the variation in institutional distance within the set of partner countries is entirely proportional to the variation in the institutional indicator score of the partner countries.

Insert Figure 2 about here

These two issues suggest that the problem that 1,N or M,1 studies really capture institutional profile rather than distance, is maybe not such a big problem after all. An initial response to this suggestion is to note that collapsing several institutional indicators into a single

index may bring about a measure that is numerically different from individual indicator scores, but not an index that for conceptual reasons measures institutional distance better. If, for instance, for each separate feature of countries' institutional profiles, distance is not captured accurately, there is no reason to believe that this problem somehow disappears just because a researcher combines different dimensions of institutions into a single index of institutional distance.

What is more, collapsing separate indicators into one index is a highly controversial move. The reason is that doing so ignores the logic of why the framework underlying the chosen indicators has distinguished separate indicators by which to capture countries' institutional profile to begin with. In case of the Kogut-Singh index, research finds that considering the Hofstede (1980) dimensions separately makes more sense from a theoretical point of view and increases explanatory power (Shenkar & Zeira, 1992; see, also, for example, Brouthers & Brouthers, 2001 and Pothukuchi et al., 2002). Indeed, the fact that the Kogut-Singh formula combines all dimensions of culture into one construct is one of the main points of critique against this formula raised by Shenkar (2001).

What about the suggestion that analyses of institutional distance are unlikely to conflate distance with partner country institutions because distances are absolute and thereby differ from scores on institutional indicators? To judge the merit of this suggestion, it is important to note that taking absolute differences in the measure of institutional distance only works as a countervailing power if the base country is somewhere near the center of the distribution of institutional profiles. Being at the center of the distribution of institutional profiles means that this base country scores about average on all institutional indicators; having an average level of corruption, bureaucratic institutions of moderate quality, and an average score on Hofstede's

cultural dimensions, particularly on Individualism and Power Distance, for example. If, however, the base country is located at one of the extremes of the distribution of institutional profiles, we end up in the situation of Figure 1. Since all partner countries are located on the same side of the base country—scoring either higher or lower on the institutional indicator than the base country—variation in institutional distance is entirely proportional to variation in institutional indicator scores.

Taken together, these considerations imply that, by taking only one base country in one's sample, one is clearly at risk of confusing institutional distance to or from the partner country with the partner country's actual institutional profile. However, this risk is particularly large when the base country of choice is located at or close to the extreme ends of the institutional indicators in use. Looking at the countries most commonly used as base country, we observe that the US scores quite extreme on most institutional indicators; it has a high level of regulatory institutions, scores high on quality of economic and political institutions, low on corruption, and is the most individualistic country in the Hofstede sample. China, on the other hand, is located very close to the collectivist end of the individualism-collectivism culture spectrum, and scores relatively low on quality of economic and political institutions. These positions of the US and China in the institutional spectrum imply that whereas using only one base country is already problematic, the particular choice of base country in most studies of distance is especially unfortunate. Because of its unique place in the distribution of institutional profiles, for the US the institutional distance to or from partner countries and the institutional profile of partner countries will amount to the same thing. Although the problem of conflation of institutional distance and institutional profile is present in any 1,N or M,1 study, the problem is empirically most profound for studies using countries such as the US as base country.

THE EMPIRICS OF DISTANCE AND INSTITUTIONAL PROFILES

The essential proof for our claim that common measures of institutional distance do not actually capture distance is mathematical. We can use empirical analysis to demonstrate its quantitative importance, however. Below we consider the three dimensions of institutional distance that derive from Ghemawat (2001), namely cultural and administrative. The Kogut-Singh index—and other composite indicators that are not widely used but serve essentially the same purpose—provide a one-dimensional measure of the distance between countries with respect to their national cultures or administrative structures and governance mechanisms. A first step in empirically assessing the extent to which 1,N and M,1 distance studies tend to conflate distance with institutions therefore is to construct a measure of a country's cultural or administrative profile that is commensurable to such distance indexes, meaning these measures also have to be one-dimensional. We take up the construction of these one-dimensional measures of institutions in the first part of this section. Parts two and three then empirically demonstrate our argument for the case of cultural distance and administrative distance. We conclude this section with a short discussion.

One-Dimensional Measures of Cultural and Administrative Profile

How can we obtain one-dimensional measures of cultural and administrative profile, comparable to distance indexes that similarly aggregate a set of institutional indicators into a single measure? We used principal components analysis that was pre-set to force the selected set of institutional

indicators into a single factor. This factor analysis disregards traditional criteria concerning the identification of factors but with good reason, namely to get to a single measure of distance in one institutional area that is commensurable to a one-dimensional measure of distance in the same institutional area.

For the culture factor, we used data on Hofstede's (1980) four indexes of national culture, namely Individualism, Power Distance, Uncertainty Avoidance, and Masculinity/Femininity. The data are publicly available from Geert Hofstede's website, <http://www.geerthofstede.nl>, and we had scores on all four indexes for 69 countries.¹ The resulting factor is mostly based on countries' scores on Individualism and Power Distance, which is consistent with how Hofstede (1980) constructed these dimensions, namely by breaking up an initial larger factor, in two subfactors, which he then labeled Individualism and Power Distance. The exact loadings on our single culture factor are -.858 and .871 for Individualism and Power Distance, compared to .506 for Uncertainty Avoidance and .068 for Masculinity/Femininity. Guatemala and Denmark are at the two extremes, scoring 1.96 and -2.16 on the standardized culture factor. The US is close to the latter of these extremes with a score of -1.63. Table A.1 in Appendix A gives descriptive statistics and Figure 3 has country scores on the culture factor on the x-axis.

¹ We dropped data that did not concern countries, but, for instance, regions such as French-speaking Canada and English-speaking Canada. A robustness check (see Table A.2 in Appendix A) shows that our results are robust to inclusion of such regional data. Of course, we did not expect our results to be affected by sample composition, given that the problem of conflating institutional distance with institutional profile is essentially a mathematical and not an empirical issue.

 Insert Figure 3 about here

We repeat this procedure for the construction of an administration factor. We use four indicators from the well-known Worldwide Governance Indicators (WGI) project (Kraay et al., 1999; World Bank, 2012), namely Rule of Law, Government Effectiveness, Control of Corruption, and Regulatory Quality. In this case, the four indicators were highly correlated and all loaded on the same factor. Factor loadings were .975 for Rule of Law, .983 for Government Effectiveness, .968 for Control of Corruption, and .957 for Regulatory Quality. Somalia scores lowest on the administrative institutions factor (-2.39), whilst Denmark once again scores highest (2.21). The score of the United States is 1.51. Data were available for 204 countries, only 69 of which are shown in Figure 3. Table A.1 in Appendix A again gives descriptive statistics

The actual empirical analysis of the extent to which measuring institutional distance is equivalent to measuring partner country institutions uses these factor scores as a baseline. Further data for the empirical analysis come from applying the Kogut-Singh formula and calculating institutional distance using either country scores on Hofstede's (1980) four dimensions of national culture as input or using countries' scores on the four WGI indicators as input (World Bank, 2012).

Since the factor analysis of the cultural variables showed that Individualism and Power Distance are the most important dimensions, we include two additional distance measures in the analysis, namely the distances on these two dimensions separately, again with the US as base country. These measures calculate the distances on Individualism and Power Distance by taking

the absolute difference between the scores of the US on these dimensions and a partner's country scores on each of these dimensions. For administrative distance, we also include distances on the four indicators Government Effectiveness, Regulatory Quality, Control of Corruption, and Rule of Law separately. These data provide the chief input for the main empirical analysis. Robustness checks include experiments with other base countries.

Culture and Cultural Distance

To examine the extent to which measuring cultural distance boils down to measuring partner country culture, Table 1 shows correlations between the various distance measures, the culture factor, and country scores on Hofstede's Individualism and Power Distance indices. The analysis is based on a sample of countries only (i.e. excluding separate entries for regions such as French-speaking Belgium and Dutch-speaking Belgium, inclusion of which could result in unwarranted increase in the number of independent observations), leaving 69 observations. Results provide strong support for the argument that, keeping the base country fixed, variation in cultural distance is proportional to variation in partner country culture, making it impossible to distinguish between the effects of both factors in analyses of international business phenomena. A first observation is that the culture factor correlates strongly with (Kogut-Singh) Cultural Distance to the US ($r = .86$). The most important correlations are those between measured distance and national culture. These can be as high as $-.82$ for Individualism and Cultural distance to the US. At the least, this correlation equals $.69$ (Power Distance and Cultural distance to the US). Particularly noteworthy is the correlation between Individualism and Distance on Individualism, which is exactly equal to 1. Finally, the high correlation between country

Individualism and Power Distance is of course in line with the earlier discussion concerning the relation between these two cultural dimensions ($r = -.59$).

Insert Table 1 about here

The perfect correlation between Individualism and Distance on individualism (Table 1) shows the influence of a country's position in the culture spectrum on the extent to which cultural distance and partner country culture indeed measure the same things. The US is the most individualistic country in Hofstede's data set, meaning that, using the US as base country, country variation in Individualism is directly proportional to country variation in Distance on Individualism. An open question concerns the correlation between measured distance and partner country culture when the base country has a different position in the national culture spectrum. Performing the original analysis with China and India as alternative base countries helps answer this question. As mentioned, much like the US, China is close to an extreme of the culture spectrum, although on the opposite end as the US. In addition, many cultural distance studies use China as the base country. The popularity as base country also holds for India (e.g., Krishnan et al., 2006; Pothukuchi et al., 2002), but India is more at the center of the culture spectrum, particularly with regards to Individualism. India's close to zero score on the culture factor serves to highlight India's central position on the culture spectrum (see Figure 3).

Insert Table 2 about here

Results are in line with expectations (Table 2). For China, there are strong correlations between measured distance and culture. Compared to the US as base country, the correlations are somewhat lower, but still high, which again strongly supports the argument that measures of cultural distance do not measure distance but capture partner countries' culture instead. For India, the most striking correlations are the ones between the Culture factor and the Cultural distance to base country, and the one between Individualism and Distance on Individualism, both of which are lower than in case of the other two base countries ($r = -.31$ and $r = -.13$). Overall, the findings for China and India provide further confirmation of the theoretical argument, showing the importance of the position of the base country in the culture spectrum for the extent to which measured culture distance actually captures partner country culture.

Quality of Government and Administrative Distance

For administrative distance, we run essentially the same procedure, with highly similar results. Having reduced the four indicators of administrative quality to a single factor, we calculate administrative distances by applying the Kogut-Singh formula to the four underlying indicators. Table 3 shows the correlations between this administrative factor and administrative distance, using the US as base country (Table 3). As expected, administrative distance is highly correlated with the administrative factor ($r = .93$).

Insert Table 3 about here

Table 3 also presents correlations between the separate underlying dimensions and distances on them. For individual dimensions, we find correlations ranging from .90 (for Control of Corruption) to .99 (for both Regulatory Quality and Rule of Law). This reveals that, for administrative distance as well, when using the US as base country, distance is indistinguishable from partner country institutional profile.

Discussion

The previous section demonstrated mathematically that distance studies using one base country conflate institutional distance and institutional profile. The results in this section indicate that the problem of this conflation is empirically highly relevant as well. For the large majority of distance studies, which used the US as a single base country, the effects of institutional distance to/from partner countries and partner country institutional profile are statistically indistinguishable. The same applies to studies using China as a single base country.

Since most of our knowledge about institutional distance is based on such studies, these results imply that most of what we think we know about the effects of institutional distance, we do not in fact know. It is very likely that the law of distance (Ghemawat's 2001, 2011) applies. The proposition makes logical sense, and there is some modest support for it by the handful studies using perceptual distance measures at the micro-level (Hakanson and Ambos 2010). Yet, the overwhelming majority of papers that are thought to provide evidence for distance-effects suffers

from fatal flaws in design. The case is therefore still inconclusive. Distance may matter. But if it does, we still need to prove it.

REDESIGNING DISTANCE RESEARCH TO STUDY DISTANCE

What can be done about the problem of conflating institutional distance and institutional profile in distance studies in management? Although superficially appealing, the solution is not to tinker with model specification, throwing in original measures of institutions next to an index supposedly measuring institutional distance. As this note finds, measures of distance to or from one base country do not actually measure institutional distance, but capture partner country institutional profile instead, and adding even more institutional variables does nothing to address this problem (whilst it may introduce some multicollinearity issues along the way). Rather, what is needed to be able to distinguish institutional distance from institutions is the simultaneous inclusion of more base countries from different ends of the institutional spectrum. If one finds, for example, that cultural distance from the US has a positive effect on, say, the likelihood that a firm adopts a particular entry mode, but cultural distance from China has a negative effect, one may safely conclude that it is not cultural distance that is responsible for the effect, but Individualism. Conversely, if one finds that cultural distance from China also has a positive effect on the likelihood of adopting this particular entry mode, the effect must stem from distance rather than from partner countries' cultural institutions.

To illustrate this argument empirically, we recalculate the correlation between the cultural dimensions of institutional distance and cultural institutions, using multiple base countries (Table 4). Results show that the high correlations between institutional indicators and

distance indicators disappear when moving to a design with multiple base countries. Correlations drop to .19 for the culture factor/cultural distance (from .85 for the analysis with the US as base country). Looking at Individualism and Power Distance separately, correlations drop even further to -.05 and -.04. These results clearly show that the relatively easy step to include multiple base countries already solves the problem of conflating institutional distance and institutional profile.

 Insert Table 4 about here

So far, unfortunately, only a minority of studies considers multiple base countries—the pioneering study by Kogut and Singh (1988) not being one of them. To our knowledge, there are no studies that include multiple base countries (home or host) in a systematic way to distinguish between the effects of institutions and of institutional distance. However, if international management scholars want to establish effects of institutional distance empirically, moving beyond the single country framework is vital. Only in this way, can distance studies separate institutions from institutional distance in a scientifically meaningful way.

CONCLUDING REMARKS

This paper considers an important, hitherto neglected problem in the way distance has been included in many analyses of international business phenomena, including foreign market entry mode and location decisions. If one uses only one base country from which to calculate distances, institutional distance to partner countries and the institutional profile of partner countries amount to the same thing. In such cases, one cannot distinguish between the effects of distance and the effects of partner country institutions.

Empirical results show that this problem is most pressing for the US, which, ironically, is by far the most popular country to serve as the base country in institutional distance research. Because of its unique position on the distribution of institutional profiles, institutional distance to or from partner countries and partner country institutions are extremely highly correlated for the US, to the extent that they are statistically indistinguishable. The same holds for another popular base country in distance research, China, which tends to be positioned at the opposite extreme of the distribution of institutional profiles.

What does this mean for distance research in management? Our empirical evidence demonstrates that the research design of the majority of distance studies does not allow researchers to make a clear study of the effects of distance. Whatever the results found, they may derive from an effect of partner countries' institutional profiles themselves rather than from an effect of institutional distance. The majority of extant studies purportedly studying effects of distance have not done so in an unambiguous way.

This does not mean that institutional distance does not matter. The argument that distance matters is theoretically plausible and is confirmed by studies using perceptual measures of distance (e.g., Håkanson & Ambos, 2010). It does mean, however, that future studies of distance should take the distinction between institutional profile and institutional distance more seriously

and adapt their research design accordingly. The rapidly growing literature on emerging markets provides an excellent opportunity to do so. The danger is that old mistakes are repeated by conducting distance studies with an emerging market country as base country. Even though the empirical visibility of the problems highlighted here may be less for other base countries than the US, the fundamental issues we discussed remain in such a set-up. A better way forward is to study institutional distance from now on exclusively by using a full set of base countries rather than one. That is the only way in which we can be sure institutional distance studies reflect the effects of distance rather than of institutions.

APPENDIX A

Insert Table A.1 here

Insert Table A.2 here

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FIGURE 1
Institutional Profile and Institutional Distances Between Fixed Base Country and Partner Countries.

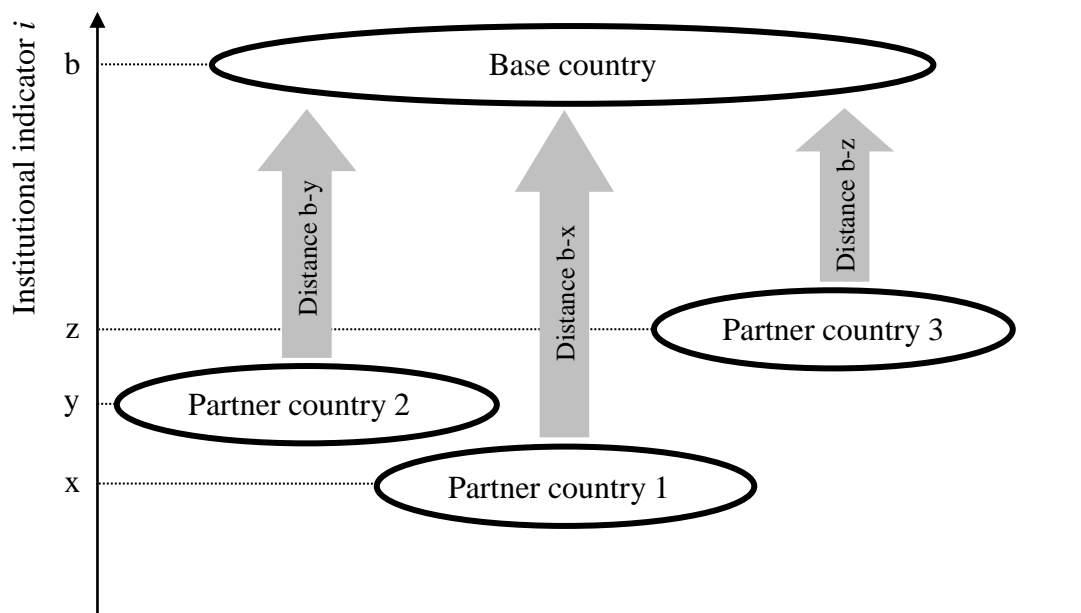


FIGURE 2
Differences in Institutions versus Institutional Distances.

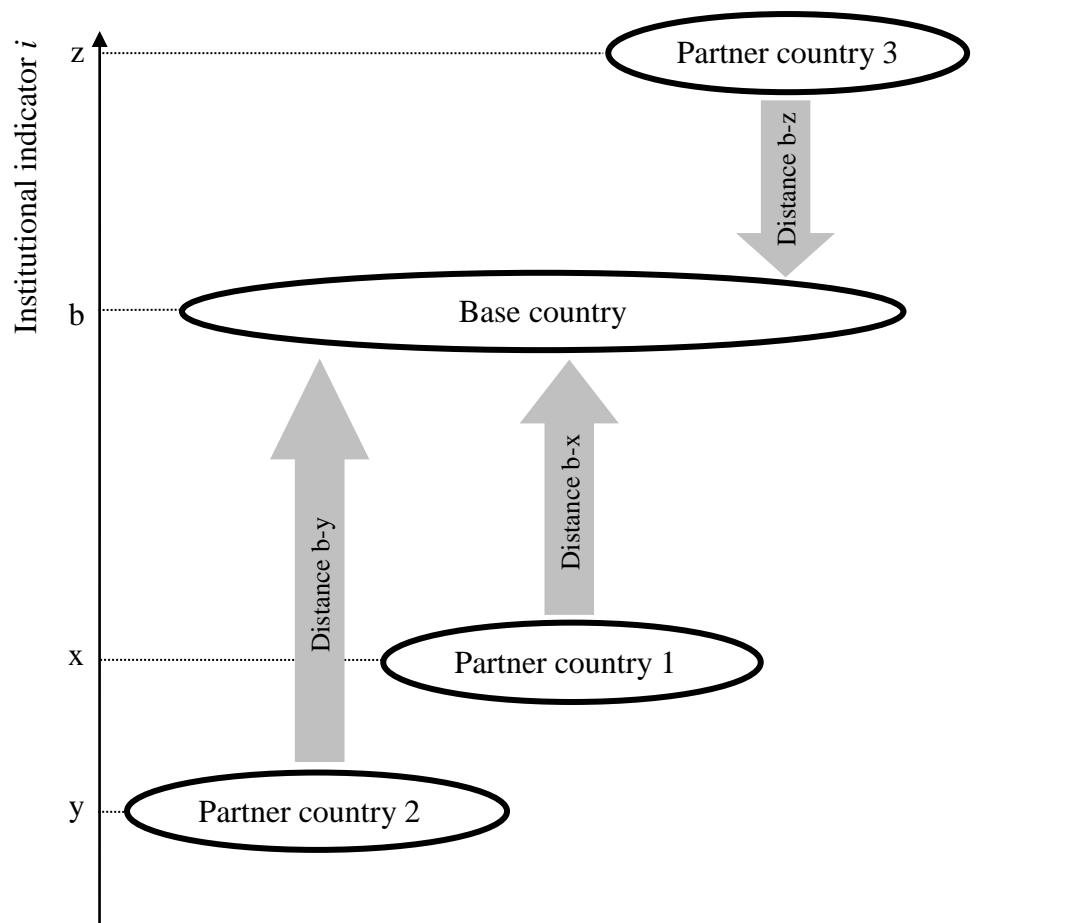
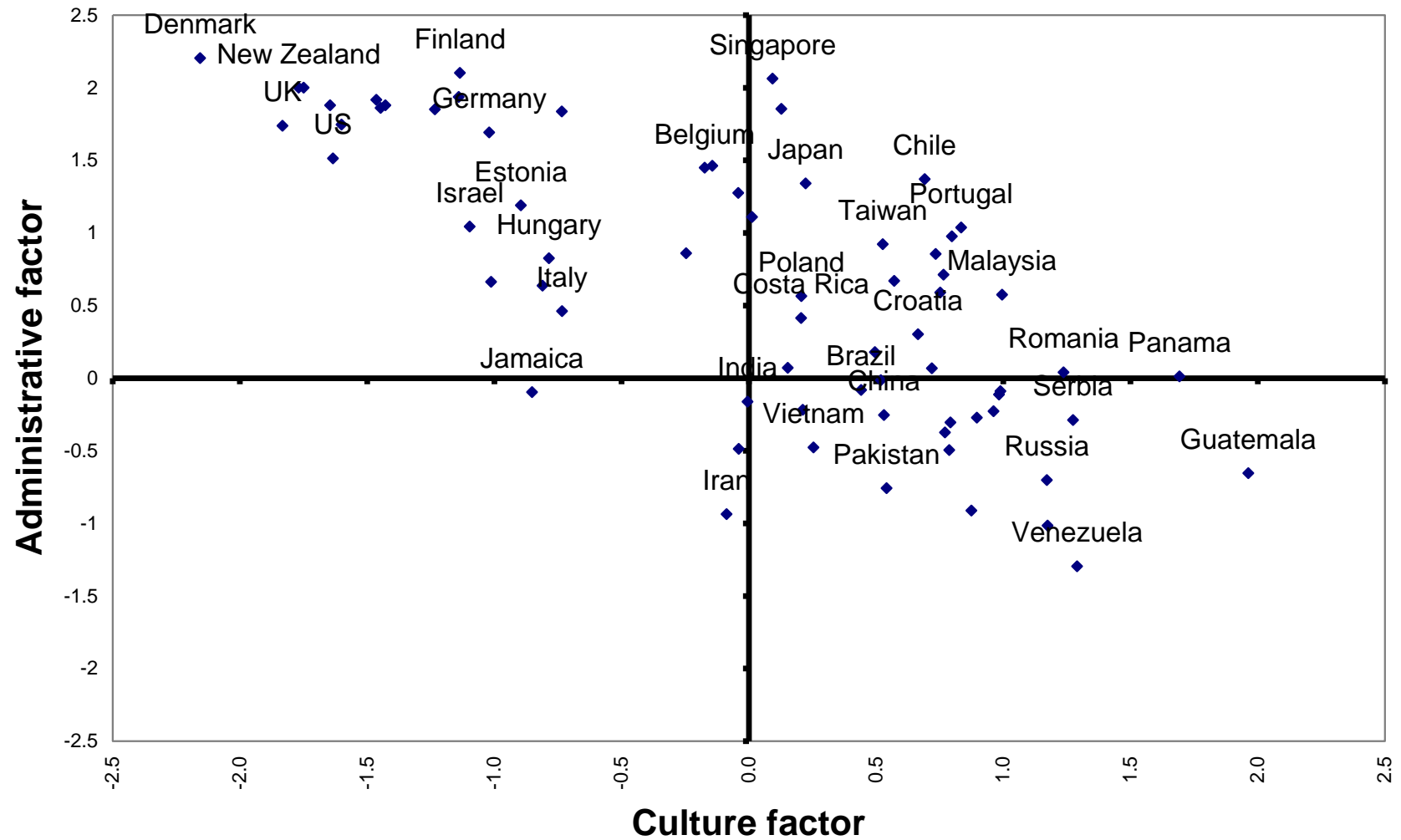


FIGURE 3
Country Scores on the Culture and Administrative Factors.



Notes: Data are own calculations based on data from Geert Hofstede's website and World Bank (2012). Complete data are available on request.

TABLE 1
Is It Culture or Cultural Distance? Correlations Between Measures of Culture and Measures of Cultural Distance.

N=68	Culture factor	Cultural distance to US	Distance on Individualism	Distance on Power Distance	Individualism
Cultural distance to US	.85	1			
Distance on Individualism	.85	.83	1		
Distance on Power Distance	.73	.70	.54	1	
Individualism	-.85	-.83	-.1	-.54	1
Power Distance	.87	.71	.62	.84	-.62

Notes: Data as in Figure 3. Number of observations is 68 with US scores excluded. Of course, correlations are higher when the US is included. The culture factor is obtained including the US (n=69). Country scores on the calculated variables are available on request.

TABLE 2
Correlations Between Measures of Culture and Measures of Cultural Distance with China or India as Base Country.

N=68		Culture factor	Cultural distance to base country	Distance on Individualism	Distance on Power Distance	Individualism
China	Cultural distance to base country	-.84	1			
	Distance on Individualism	-.84	.77	1		
	Distance on Power Distance	-.84	.79	.66	1	
	Individualism	-.86	.72	.97	.64	1
	Power Distance	.87	-.70	-.61	-.88	-.62
India	Cultural distance to base country	-.31	1			
	Distance on Individualism	.00	.03	1		
	Distance on Power Distance	-.81	.59	-.03	1	
	Individualism	-.86	.31	-.13	.64	1
	Power Distance	.88	-.46	.00	-.83	-.63

Notes: See Table 1. Number of observations is 68 with the scores for the selected base countries—China or India—excluded because of zero distance. The culture factor is obtained including the selected base countries (n=69). The exclusion of the base country explains why correlations between Individualism and Power Distance are not exactly the same for China ($r = -.62$) and for India ($r = .63$), even though they are based on largely the same sample. Country scores on the calculated variables are available on request.

TABLE 3
Correlations Between Administrative Indicators and Measures of Administrative Distance.

	Administrative factor	Administrative distance to US	Distance on Government Effectiveness	Distance on Regulatory Quality	Distance on Rule of Law	Distance on Control of corruption	Government Effectiveness	Regulatory Quality	Rule of Law
N=203									
Administrative distance to US	-.93	1							
Distance on Government Effectiveness	-.96	.94	1						
Distance on Regulatory Quality	-.94	.94	.94	1					
Distance on Law	-.96	.93	.93	.89	1				
Distance on Control of Corruption	-.89	.90	.90	.83	.91	1			
Government Effectiveness	.98	-.91	-.98	-.93	-.93	-.85	1		
Regulatory Quality	.96	-.92	-.93	-.99	-.89	-.81	.94	1	
Rule of Law	.98	-.91	-.92	-.89	-.99	-.88	.94	.90	1
Control of Corruption	.97	-.86	-.89	-.85	-.93	-.90	.94	.87	.95

Notes: Table 1. Number of observations is 203 with US scores excluded (note that not all observations are included in Figure 3). Of course, correlations are higher when the US is included. The administrative factor is obtained including the US (n=204). Country scores on the calculated variables are available on request.

TABLE 4
Correlations Between Measures of Culture and Measures of Cultural Distance with Multiple Base Countries (M,N).

N=136	Culture factor	Cultural distance	Distance on Individualism	Distance on Power Distance	Individualism
Cultural distance	.19	1			
Distance on Individualism	.04	.72	1		
Distance on Power Distance	-.08	.68	.53	1	
Individualism	-.85	-.15	-.05	.07	1
Power Distance	.87	.10	.03	-.04	-.62

Notes: See Table 2. Number of observations is 136, 2 x 68 (with scores for the US and China excluded in case of zero distance). Of course, correlations are higher when the US and China are included (for n=138).

TABLE A.1
Summary Statistics.

	Mean	SD	No. of Obs.
Culture factor	0	1	69
Cultural distance	2.47	1.40	69
Distance on Individualism	47.3	24.0	69
Distance on Power Distance	23.8	16.6	69
Individualism	43.7	24.0	69
Power Distance	59.1	21.9	69
Administrative factor	0	1	205
Administrative distance to US	3.17	2.75	205
Distance on Government Effectiveness	1.55	0.90	205
Distance on Regulatory Quality	1.53	0.95	205
Distance on Law	1.64	0.94	205
Distance on Control of Corruption	1.42	0.79	205
Government Effectiveness	0.01	1.00	205
Regulatory Quality	0.01	1.00	205
Rule of Law	-0.01	1.00	205
Control of Corruption	0.00	1.00	205

TABLE A.2
Robustness of the Correlations Between Measures of Culture and of Cultural Distance.

N=77	Culture factor	Cultural distance to US	Distance on Individualism	Distance on Power Distance	Individualism
Cultural distance to US	.86	1			
Distance on Individualism	.84	.82	1		
Distance on Power Distance	.73	.69	.54	1	
Individualism	-.84	-.82	-.1	-.54	1
Power Distance	.87	.69	.59	.84	-.59

Notes: Compared to Table 1, results include the following regions included in Hofstede's dataset: Africa East, Africa West, Arab countries, Belgium French, Belgium Dutch, Canada French, South Africa White, Switzerland French, and Switzerland German (9 in total), for a total of 77 observations. The culture factor is obtained including these regions as well as the US (n=78). Country scores on the variables are available on request.