An extended abstract of the paper "Avoiding "cultural distance paradox" – Switching to cultural friction lens. An empirical study on foreign divestment"

Ha-Nguyen, T.T.[1], Larimo, J.[1], Dow, D.[2]

[1]School of Marketing and Communication, University of Vaasa, Finland;

[2]Melbourne Business School, University of Melbourne, Australia

Abstract*

We extend institutional theory by examining the role of cultural friction between foreign subsidiaries and host countries in foreign divestment decisions. Furthermore, our study supplements the theoretical arguments and provides empirical evidence for switching from cultural distance to cultural friction. Based on a sample of 2,004 foreign investment cases made by 333 Finnish MNEs in 41 host countries during 1970-2010, we find the U-shaped relationship between cultural friction and foreign divestment probability. The relationship is further contingent on the lubricant effect of entry mode. Theoretical and practical implications of the paper are discussed, along with directions for future research on international business strategies.

Keywords: foreign divestment, subsidiary performance, cultural friction, cultural distance, cultural distance paradox, institutional theory.

*the paper is available from the author

The institutional theory has been widely applied in MNEs studies because it provides a strong and rich theoretical background for explaining a wide range of critical issues at multiple levels (Kostova, Roth and Dacin, 2008). Applying the theory, scholars have explained the role of institutional environments in different MNE strategies such as partner selection, location choice or firm strategic decision. Albeit its illusions (Shenkar, 2001, 2012; Drogendijk and Zander, 2010), cultural distance, referring to the difference or similarity between the two national cultures, is confirmed to significantly influence the organizational legitimacy and likelihood of being divested (Meschi and Wassmer, 2013; Pattnaik and Lee, 2014; Kang, Lee and Ghauri, 2017).

Zaheer, Schomaker and Nachum (2012, p.19) state that “international management is management of distance”, in which the institutional theory of business systems has highlighted the key role of cultural distance in international business (IB) strategies (Berry, Guillén and Zhou, 2010; Shenkar, 2012; Cuypers, Ertug, Heugens, Kogut and Zou, 2018). Nevertheless, the contradictory results found in previous studies on the impact of cultural distance or the so-called “cultural distance paradox” (Brouthers and Brouthers, 2001) bring the idea of the contextual situation for individual cases. Stated differently, depending on specific situations, the impact of the cultural distance on the subsidiary’s legitimacy will likely be different. Therefore, the cultural distance should be considered both at the national and the firm levels such as how the firms perceive the distance. Hence, the dominant role of cultural interaction, which may accelerate or lessen the perceived distance, is catching more attention (e.g. Shenkar, 2001; Reus and Lamont, 2009; Koch, Koch and Shenkar, 2016; Li, Liu and Qian, 2019). Scholars also highlight the bias of “negative impact” which repeatedly reported among cultural studies (Stahl and Tung, 2015). While a few researchers emphasize the benefits of operating at culturally distant countries, the curvilinear effect of cultural distance receive inadequate attention. Furthermore, as MNEs always have strategies to deal with uncertainties at foreign markets such as adjusting their ownership strategies or make an appropriate entry mode, cultural studies have highlighted the influence of entry mode. Nevertheless, its role in defining cultural distance at different levels are understudied. We aim at filling in some of the gaps in the culturally distant literature by pointing out why cultural distance is not appropriate to measure the cultural difference and providing empirical guideline for a switch to an advanced alternative. More specifically, this study discusses the theoretical advancements of and empirically investigates the impact of cultural friction on the foreign divestment probability. We also explore the moderating effect of entry mode as a lubricant factor on this relationship. In other words, our study aims to answer the following research question ***“How does cultural friction influence the foreign divestment decision and what is the moderating role of subsidiary’s entry mode in this relationship?”***

Our study differs from previous cultural studies and contributes to the cultural literature in several meaningful ways. First, we extend the institutional theory by theoretically arguing and empirically proving the role of cultural interaction between firms and the host institutions. As such, we switch from distance to friction concept to measure the impact of the cultural differences. We confirm that the cultural difference evaluated as national level or the cultural distance matter though, how the subsidiary perceives the difference or the specific cultural interaction is even more important. Our findings also provide empirical evidence for the reliability, accuracy, and suitability of the cultural friction concept proposed by Shenkar (2001). Second, while the original institutional theory posits the negative impact of cultural distance only, we challenge this repeatedly hypothesized linear effect in prior studies. Our findings confirm the significant and curvilinear relationship between cultural friction and foreign divestment probability. Third, while recent literature has evaluated the impact of cultural friction on various IB topics (Koch et al., 2016; Singh, Pattnaik, Lee and Gaur, 2019), our study is the first attempt applying this concept to the foreign divestment context, which has been recently reported as a striking business phenomenon (UNCTAD, 2018). Consistent with the friction literature, we further examine the lubricant effect of entry mode (greenfield vs. acquisition) on the main hypothesized relationship. Fourth, due to several illusions belonging to the concept and operationalization, we measure cultural friction based on GLOBE cultural framework (House, Hanges, Javidan, Dorfman and Gupta, 2004) combining with Mahalanobis distance approach (Berry et al., 2010), instead of using Hofstede-based Kogut and Singh’s approach that Luo and Shenkar proposed (2011). Testing the hypotheses regarding the divestment probability by both survival analysis and logistic regression, we answer Shenkar’s call (2001) and develop our knowledge on how to predict the subsidiary divestment in the host country by measuring more correctly the cultural differences.