

Cultural distance and subsidiary performance in understudied countries

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Abstract

Since the last decades, multinational enterprises are increasingly opening up subsidiaries in regions outside of the Western world. These countries are different from the well-studied Western countries. The questions rises whether cultural difference affect the firm and the subsidiary in the same way in these countries. Starting from the theory of New Organizational Institutionalism, the aim of this thesis is to research whether cultural difference in these lesser studied countries has the same effect on the performance of subsidiaries as for the Western countries. By combining data on subsidiaries form Indian MNEs with the Hofstede-index, I analyzed the relationship. No significant relationship was found between the cultural difference and the subsidiary performance. Institutional quality was significant as a mediator. Having prior experience in the region did not serve as a mediator for cultural distance.

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1. Introduction

Academic literature that researched the effects of cultural differences on the performance of multinationals has largely been about multinational enterprises (MNEs) in Western countries. Krugly-Smolka (1994) already argued that science in general has, historically speaking, focused too much on Western countries and too little on other parts of the world. Additionally, Redding (2005) described how in international business theory there is too little focus on context and that all countries are viewed through the same lens. This paper will therefore focus on the effects of cultural distance on subsidiary performance in understudied countries. There are a lot of understudied in the countries in the world, where we assume that the effects of cultural differences on the performance of subsidiaries of MNEs are the same as in these well-studied Western countries, while that might not be the case. In other sectors of science, it has been proven how such assuming such similarities is wrong. For example in the medical field, where it was assumed that women would suffer from the same symptoms of heart attacks as men do. Only after studying female heart attacks, it turned out that these symptoms can actually differ significantly (Nedelman, 2017).

Fainshmidt et al. (2018) delved into these countries and created a list comprising 68 understudied countries. These countries tend to be countries that are not as developed as Western European countries. They are mainly located in Africa, the Middle East, East Europe, Latin America and Asia. However, Fainshmidt et al. also argue that the institutional context in these countries is diverse and unique. Such different contexts can lead to a different outcomes. Meyer (2015, p.369) stated: 'Principally, all management scholars aspiring a theoretical contribution should be concerned about context'. Therefore, I want to prolong the question about cultural differences and subsidiary performance to the contexts of these understudied countries with the following central question:

What is the effect of cultural differences between countries on subsidiary performance in understudied countries?

While it is important for academics to study understudied countries, the answer to this question is also relevant to managers of MNEs worldwide. These understudied countries are in regions that are becoming more economically relevant and their role in the globalization process has become larger over the years. Obeng-Odoom (2014) describes how the narrative

has changed from a negative economic view on Africa towards a 'rising Africa', where markets are opening up and investments are rising. Rogers (2018) shows how (Chinese) investments are increasing exponentially in South American countries like Argentina and Venezuela and Shambaugh (2018) describes how the United States and China are battling economically in Southeast Asia. The literature shows that these understudied countries are extensively becoming targets for MNEs to open up subsidiaries in. Therefore, the central question about cultural differences and their effects on performance in understudied countries is relevant for MNEs as well.

This paper will make use of the cultural dimensions as described by Hofstede (1983). I will exploit the variance in these dimensions and measure the cultural difference between the host country and home country in that way. By regressing the return on assets of MNE subsidiaries on these cultural differences I will be able to draw a conclusion about the effect of cultural distance.

The aim of this thesis is to contribute to the current academic literature in two ways. First of all, its purpose is to shed light on these countries that were not the subject of earlier research, and to show whether the effects of cultural differences are different there than they are in the Western, more studied countries. Second, the thesis aims to contribute to the understanding of the role of quality of institutions when it comes to cultural differences. Starting from the concept of North (1990) that institutions are needed for organizations, the paper will show whether stronger or weaker institutions play a role in the overcoming of cultural distance.

This paper will be structured as follows. Chapter 2 will contain the literature review and the introduction of the hypotheses. Chapter 3 will present the methods. Chapter 4 will present the results. Chapter 5 will serve as a discussion of the results and will conclude the paper.

2. Literature review

2.1 Cultural distance and performance

When firms go abroad, they face distinct cultures that are often different than the cultures in their home country. The magnitude of this cultural difference has been defined as cultural distance in the academic literature. Hofstede (1983) created a four-point framework for the quantification of this distance. This was later expanded to five (Hofstede, 2003) and currently consists of six dimensions. Such distance is expected to influence a firm's activity when going abroad (Sousa and Bradley, 2008). Studies have shown that firms perform better in countries with similar cultures, and thus with a smaller cultural distance (Bilkey and Tesar, 1977; Lee, 1998; Pothukuchi et al., 2002). Kostova et al. (2016) argues that this is because cultural distance leads to complex situations and creates obstacles, and hinders efficiency for the subsidiary. Not speaking the same language, or having different manners when it comes to conversations and hierarchy are a good example for this. As a result, firms perform worse. Furthermore, uncertainty for the firm in such an agency situation with a subsidiary increases these obstacles. The overwhelming qualitative literature on the subject of cultural distance follows this argument. Zaheer (1995) also brought forth this idea and presented the term 'Liability of Foreignness', which describes 'the extra costs of doing business abroad that result in a competitive disadvantage for an MNE subunit'. These costs stem from the spatial distance due to distance between the home and host country, the unfamiliarity of the firm with the host country and a lack of legitimacy in the host country, often leading to discrimination. This unfamiliarity presents itself through a similar argument as Kostova et al. brought forth, but the lack of legitimacy is an addition to the argument of Kostova et al. If consumers in the host country are more hesitant of buying from a subsidiary whose headquarters are in a culturally different country, this hurts the subsidiary performance. It is to assume that when this difference is larger, consumers will be more hesitant and performance will be hurt harder. However, positive effects have been stipulated in the literature. Morosini et al. (1998) and Gomez-Mejia and Palich (1997) argue that some positive effects can stem from cultural differences, as different cultures can learn from and use each other's competences. Morosini et al. (1998) find empirical evidence for this.

The empirical literature on this topic mostly points towards a negative effect of cultural distance on performance. Mulok and Ainuddin (2010) use the Hofstede-dimensions to analyze the effect of cultural difference on subsidiary performance of Malaysian firms, where they find a negative effect. Beugelsdijk et al. (2018) argue in a meta-analysis that 'cultural distance has a strong negative effect on subsidiary performance'. Qin et al. (2017) studied the effect of cultural distance on subsidiary performance in China and also found a negative effect. Furthermore, cultural differences often obstruct the likelihood for success for mergers and acquisition (Dikova et al, 2010; Ahammad et al, 2016; Basuil and Datta, 2015). However, there is also contrasting literature. Tihanyi et al. (2005) find no significant effect on performance and Morosini et al. (1998) find significant positive effects.

In short, because cultural difference can lead to complexity and firms may face discriminatory behavior due to a lack of legitimacy, it is to be expected that cultural differences lead to worse performances, also in understudied countries. Therefore, the first hypothesis is the following:

Hypothesis 1: Cultural distance has a negative effect on subsidiary performance in understudied countries.

2.2 Institutional quality and cultural distance

North (1990) presented the idea that institutions are 'the rules of the game in a society' and 'human devised constraints'. Institutions are a necessity in a world where organizations are incompletely informed and have imperfect models for analysis. If such institutions would not exist, transaction costs would arise, leading to lower efficiency (Coase, 2013). In other words, organizations need institutions to be able to function optimally. Like Coase, North also argues that institutions can mitigate transaction costs. Prolonging this to the context of cultural distance, it implies that institutions could help overcoming these extra (transactional) costs for foreign subsidiaries. Since these foreign firms and their subsidiaries face a new culture where they face unfamiliarity issues, an effective government with a clear set of rules and a strong executive force for such rules could make this unfamiliarity issue less of a problem; After all, all formal rules are clearly stated and acted upon. On the contrast, the institutional quality in understudied countries, which are mostly developing countries, is on average lower than the institutional quality in the more studied, often

Western countries, and therefore one can question whether in these countries institutions are still capable help out these foreign firms and their subsidiaries. Kostova et al. (2016) describe how institutional quality plays a role when it comes to subsidiary performance. Whereas the more economically developed countries have stronger institutions, the less economically developed countries are often characterized by weaker institutions and 'institutional voids' (Khanna & Palepu, 1997). These voids create a sense of risk and uncertainty in a country. Such risks and uncertainty might increase the problems caused by cultural distance already. A majority of the countries that are described by Fainshmidt et al. (2018, full list in the Appendix) are characterized by institutions of lower quality. Next to the uncertainty issue, strong institutions could also act and help when firms face discriminatory behavior or other harmful actions. However, weaker institutions will not be able to do so, and therefore they will not be able to mitigate the problems faced because of cultural distance. To conceptualize: if a subsidiary from a culturally distant country would face breach of contract by a domestic firm in the host market, the subsidiary is more likely to receive help from a non-corrupt government with a strong rule of law, opposed to of a corrupt government with weak rule of law. One can therefore expect that cultural difference is more of a problem in these countries than in the more studied countries.

There is not a lot of empirical evidence for whether there is a mediating effect of institutional quality on cultural distance, but some articles hint towards such an effect. Liou et al. (2016) showed how MNEs are more careful when engaging in foreign markets with lower institutional quality. Herrera-Echeverri et al. (2014) showed how there is less 'business creation' in countries with lower institutional quality. Ojeka et al. (2019) and Bhaumik et al. (2012) show that performance of firms is negatively affected by low institutional quality. While these papers do not show an interacting effect with cultural distance, it does show that MNEs are aware of the obstacle that is low institutional quality, and that it might affect their performance if they were to create a subsidiary in a country with low institutional quality. This direct effect might also be biased to some extent by the mediating effect, since the articles mentioned do not control for that. However, clear empirical evidence in the literature is absent.

In short, due to the incapability of weaker institutions to step in and assist subsidiaries from other countries when they face new cultures, it is likely that the negative consequences of cultural distance will not be mitigated. Therefore, the third hypothesis is the following:

Hypothesis 2: The negative effect of cultural distance on subsidiary performance is stronger in understudied countries with low institutional quality.

2.3 Prior international experience

In a literature review on the subject of organizational learning, Levitt and March (1988) describe how firms learn from lessons in the past and use this information to make better decisions later on, despite the turnover of personnel and the passage of time. In the case of multinationals opening up a subsidiary and having to deal with cultural distance, such organizational learning might be present as well. Shenkar and Zeira (1992) argued and showed that through organizational learning prior knowledge about culture can be used to deal with new uncertainties that are presented in the future. This means that if a MNE expands with a new subsidiary, they would be more capable of dealing with cultural distance as a result of prior experience in dealing with cultural differences. Perkins (2014) argues that such cross-border experience needs to be relevant, in order for there to be a form of organizational learning. If a firm has experience in a country that is completely different from the next country they go to, the experience does not have much worth. In fact, Perkins (2014) even argues that such experience can harm a firm more than it has benefit, because it can lead to overconfidence from managers believing that they have the necessary experience, while they do not. From this standpoint, organizational learning for MNEs is only relevant if prior experience has been gained in a country that is similar to the country where a MNE is going to open up a new subsidiary. Considering the fact that countries that are in the same geographical region often share a large extent of their culture, this would mean that experience gained in a country in the region could serve as mediator.

Most of the empirical literature points towards a positive effect of experience. Shenkar (2001) showed in a literature overview how experience is generally a moderator on cultural distance. Popli et al. (2016) argue that prior cross-border experience is a dynamic firm-specific capability, which can be seen as indispensable when overcoming cultural differences. Barkema and Drogendijk (2007) found that companies benefit from earlier

experience in a 'cultural bloc', being a geographic region where countries have very similar cultures. Cho and Padmanabhan (2005) find that experience serves as a mediator for Japanese firms and can help overcome the costs caused by cultural distance to some extent. However, Li et al. (2014) find no significant effect for international experience as a moderator.

In short, due to a multinational enterprise learning lessons from prior experience concerning culture in a similar country, one can expect them to take this knowledge into account when setting up a new subsidiary in that region. Such knowledge might help to (partly) overcome the problems and uncertainty faced because of cultural difference. Therefore, the third hypothesis is the following:

Hypothesis 3: Prior experience in a country in the region serves as a moderator for the effect of cultural distance on subsidiary performance in understudied countries.

3. Methods

3.1 Databases

To study the effect of cultural distance on subsidiary performance, I use three different databases. Observations on subsidiaries and their performance will be retrieved from the Orbis-database. Orbis is a database brought forth by Bureau van Dijk, an independent analytics company originally from Belgium. Their database covers information about private companies and describes the activities and performance of those companies, as well as their ownership structures, financial risks and other relevant company information. The specific dataset I use for this thesis contains 4092 observations, and contains data about 791 subsidiaries over the years 2004 to 2012 across 19 different sectors in 62 different countries. Out of the 62 different countries, 30 are classified by Fainshmidt et al. (2018) as understudied countries. The full list of all the countries can be found in the Appendix. Out of the 4092 observations, 753 are in these understudied countries. To determine whether the firm had prior experience with a subsidiary in the region, all the firms and their subsidiaries were manually looked up. Descriptive statistics for the entire sample and the sample of understudied countries can be found in the Appendix.

Second, I use the Hofstede-database, in which scores on a scale of 1-100 are attached to each of the six dimensions Hofstede distinguished per country. This database covers a broad scope of countries, ranging from highly developed countries such as the Netherlands, to less developed countries like Guatemala and Malaysia. In total, it covers 111 regions. Most of the times such regions are countries on their own. However, some exceptions are made, when Hofstede creates one measurement for a region of countries, for example when he creates one measurement for East African and West African countries, or Arab countries. Five countries that were in the Orbis-database were not covered in the Hofstede database, being Bhutan, Botswana, Sri Lanka, Nepal and Oman. The observations from these countries were dropped, amounting to 72 observations. Furthermore, Kenya and Mauritius were not in the database as a country on their own, but based on their geographical location, I qualified both countries as being part of East Africa.

Lastly, I use the Worldwide Governance Indicators from the World Bank. This database covers all the countries in the world and judges the quality of institutions in five different ways. These are the following: Control of Corruption, Government Effectiveness, Political Stability and Absence of Violence/Terrorism, Regulatory Quality and Voice and Accountability. The World Bank updates these every year. Data on GDP per capita was also retrieved from the World Bank.

3.2 Variable operationalization

3.2.1 Dependent variable

The dependent variable in this thesis is subsidiary performance. Previous research that compares performance across countries (for example: Pattnaik et al., 2015, Click, 2005; Wan and Hoskisson, 2003; Majocchi et al., 2015) follow a setup where they use Return on Assets (ROA) as the dependent variable. As it is common practice, I will use the ROA of the subsidiaries as the dependent variable.

3.2.2 Independent variable

The main independent variable of interest is the measure for cultural distance. This variable will be constructed through an algebraic formula first proposed by Kogut and Singh (1988). I adjust their formula slightly since their formula only accounts for four dimensions of cultural

distance, while currently six dimensions are being acknowledged. The variable will be constructed with the following formula:

$$CD_j = \sum_{i=1}^6 \{(I_{ij} - I_{ih})^2 / V_i\} / 6 \quad (1)$$

Here, I_{ij} stands for the index of cultural dimension i in foreign country j . I_{ih} stands for the index of cultural dimension i in home country h , which is India in this dataset. V_i is the variance of the index of dimension i . With this formula, one calculates the cultural distance between the home country and country j . Kogut and Singh (1988) explain that through this scaling method, any measurement error can theoretically not be expected to be correlated with any other independent variable. By squaring the cultural distance they get rid of negative values and through division they take the variance into account. To get an average, they divide by the number of cultural dimensions. It is worth noting that the Hofstede-index is a time-invariant variable, while the Return on Assets for subsidiaries is actually time-variant. This variable for cultural distance will therefore be unable to capture the variance in subsidiaries' performance over time. When testing for hypothesis 2 and 3, I will use interaction variables of cultural distance with a second variable. For hypothesis 2, this will be an interaction variable of cultural distance with institutional quality. Data on institutional quality is retrieved from the World Bank, who scores every country on a scale of -2.5 to 2.5 in five dimensions. I took an average score across these five dimensions, and later added 2.5 to every observation, to get rid of negative values. This makes interpreting the variable easier. For hypothesis 3, I created an interaction variable of cultural distance with a dummy variable for whether the firm had prior experience in the region through a subsidiary in the region. Whether the firm had prior experience was researched by manually looking up the firms and checking where their subsidiaries were located.

3.2.3 Control variables

Lastly, two types of control variables are being used. First, I use firm-specific control variables. These will be the size of the firm, the Return on Assets of the overall firm, the age of the subsidiary and whether the subsidiary operates in the same sector as the firm. The reasoning is that all these variables can reflect a stronger position and larger capability of the firm and subsidiary to deal with the problems that arise due to cultural distances and thus obtain higher ROAs despite them. In order to single out the effect of cultural distance, one

needs to control for them. Second, I use one country-specific control variable. This will be GDP per capita. There is a high likelihood that higher ROAs can be obtained in countries that are economically stronger, even if cultural distance between the home and the host country is large. To make sure this does not bias the coefficient of cultural distance, I control for it.

3.3 The model

For the regression, I will use a random effects-model. One cannot use an OLS-estimation in this setting, since it requires homoskedasticity. However, in this setting, it is likely that the error-term will have larger or smaller variances per country, or per firm. Furthermore, it is also not to be expected that the error term would have zero autocorrelation. Fixed effects cannot be used either, since the main independent variable is time-invariant and measured on the country-level. Therefore, the random effects-model is to be preferred. For the random effects estimation, I group the observations per host country, since grouping them per subsidiary would lead to an unbalanced sample. Furthermore, I include robust standard errors to correct for potential heteroskedasticity. For hypothesis 2 and 3, I will use an interaction variable as described before. This means that both the independent variables, as well as the interaction variable will be included in the regression equation. These hypotheses will be tested solely on countries that have been identified as understudied, while for the first hypothesis, I run the model for the entire dataset, for the sample of understudied countries and the sample of non-understudied countries. To determine which countries were selected as understudied, I cross-referenced the Orbis-database with the list of understudied countries Fainshmidt et al. (2018) created.

4. Results

This section will serve as a presentation of the results. The implications will be discussed further in the discussion section. For answering the first hypothesis, I first ran a basic random effects regression of the subsidiaries' Return on Assets on the quantified cultural difference. Hereafter, I added the control variables as described in the methodology section. The coefficients for the independent variable for the first hypothesis can be found in Table 1.

Table 1: This table displays the coefficients for the regression used for the first hypothesis. Column 1,2 and 3 are the basic regression, with just the Hofstede difference as an independent variable. Column 4,5 and 6 also include the control variables as mentioned in the methodology section. The robust standard errors are displayed between brackets. *** indicates significance on the 1%-level, ** on the 5%-level and * on the 10%-level. R-squared displays the between R-squared.

	Full sample	Understudied	Non-understudied	Full sample	Understudied	Non-understudied
Hofstede difference	.2632695 (1.046847)	-1.095273 (1.655455)	1.88975 (1.654969)	.316389 (1.268913)	-1.408686 (2.018666)	1.397288 (1.288962)
Firm ROA				.1438832** (.0573982)	.1960268 (.1293144)	.1348289** (.0614388)
GDP per capita				-.0000477 (.0000514)	-.0000541 (.0001395)	-.0001151 (.0000777)
Firm size				.0072302 (.0168641)	-.0029829 (.025009)	.0132279 (.0186742)
Same industry				.2714238 (1.041639)	-.4159694 (2.061819)	.473179 (1.240688)
Subsidiary age				.0714496*** (.0145338)	.0756564 (.1089372)	.0728586*** (.0126177)
Constant	2.175598 (2.206847)	3.923082 (2.719879)	-1.20218 (4.044487)	1.351033 (2.427603)	2.561359 (3.583248)	3.164753 (3.71621)
Number of observations	3,980	713	3,267	3,857	663	3,194
R-Squared	0.0001	0.0740	0.0481	0.0684	0.3458	0.1200

For the first hypothesis, I first ran the regression for the full sample and afterwards split the sample in understudied and non-understudied countries. None of the coefficients that were found were significant. For understudied countries, the coefficient pointed towards a negative effect in contrast to the other two samples, but no conclusions can be drawn from this due to the lack of significance. The addition of control variables did not alter much, as the coefficients for cultural difference were non-significant after their inclusion. The coefficient for the understudied countries was the only one that hinted towards a negative effect, but it is insignificant as well. As a result, the first hypothesis of this thesis, stating that cultural difference had a negative effect on subsidiary performance in understudied countries, is rejected. Notably, the coefficients for the firm's Return on Assets and the age of the subsidiary were significant for the full sample and the sample with non-understudied countries, but insignificant for understudied countries. The increase in R-squared after adding the control variables is also worth noting, especially in the sample with understudied countries. While only 7.4% of the variance in subsidiaries' ROA could be explained by the independent variable basic regression, 34.58% of the variance in subsidiaries' ROA could be explained by the independent variables in the regression with control variables.

Table 2: This table displays the coefficients for the regression used for the second and third hypothesis. The first model contains only control variables and with each model thereafter, independent variables of interest are added. Model 7 contains all relevant control variables. The robust standard errors are displayed between brackets. *** indicates significance on the 1%-level, ** on the 5%-level and * on the 10%-level. R-squared displays the between R-squared.

	(1)	(2)	(3)	(4)	(5)	(6)	(7)
Hofstede difference		-1.408686 (2.018666)	-7.389729 (1.898061)	-11.5098** (5.602091)	-7.516618 (2.116973)	-3.853835 (4.195048)	-13.88647** (6.594256)
Institutional Quality			-4.875665** (2.103736)	-11.14653** (4.531002)			-9.992304** (4.728239)
Hofstede * Institutional				4.971369** (2.508792)			4.711625* (2.619539)
Prior experience					6.313959*** (2.443364)	2.23772 (5.616715)	1.171993 (5.352063)
Hofstede * Experience						3.711945 (3.799455)	4.246356 (3.556442)
Firm ROA	.2011195 (.1279992)	.1960268 (.1293144)	.2188292* (.1306652)	.1864069 (.1285404)	.1654646 (.1175512)	.167901 (.1159716)	.1622035 (.1157659)
GDP per capita	-.0000581 (.0001446)	-.0000541 (.0001395)	.0001236 (.0001084)	.000128 (.0001232)	-.0000357 (.0001347)	-.0000497 (.0001317)	.000092 (.0001294)
Firm size	-.0081254 (.0261866)	-.0029829 (.025009)	-.0145453 (.0243267)	.0033088 (.0274962)	-.0256696 (.0283687)	-.0286242 (.0296123)	-.0215856 (.0309761)
Same industry	-.5368742 (2.006257)	-.4159694 (2.061819)	-.0788474 (2.034818)	-.5585156 (1.991671)	-1.361368 (2.001497)	-1.293547 (2.073201)	-1.364047 (2.012811)
Subsidiary age	.0610296 (.1002643)	.0756564 (.1089372)	.059428 (.1053414)	.0552397 (.1051862)	.060649 (.1048071)	.0552767 (.1047257)	.0376651 (.1027005)
Constant	1.075999 (3.022595)	2.561359 (3.583248)	11.84066* (6.342332)	25.52272** (11.19339)	-.9429643 (3.892167)	2.833693 (5.953122)	24.17084* (12.69186)
Number of observations	663	663	663	663	663	663	663
R-Squared	0.2864	0.3458	0.3871	0.4016	0.3103	0.2578	0.3714

For the second hypothesis, I argued that a lack of institutional quality in understudied countries can worsen the effect of cultural difference. Results for this hypothesis can be found in Table 2. The addition of the variable for institutional quality to the regression with controls led to a positive coefficient, significant on the 5%-level. Hereafter, I also added an interaction variable between cultural distance and institutional quality, as can be seen in model 4 in Table 3. In this model, the coefficient for both institutional quality as well as the interaction variable is positive. The R-squared in this model is also the highest across all models, with 40.16% of the variance in subsidiaries' ROA being explained by the independent variables. Model 7, which contains all the independent variables, also shows a positive coefficient that is significant on the 10%-level. Based on these findings, I conclude that the second hypothesis is not rejected, and that there is evidence that institutional quality does actually serve as a moderator for cultural difference.

For the third hypothesis, discussing the importance of prior experience in the region, I first added the variable for prior experience to model 2, resulting in model 5, which can be found in Table 2. Afterwards, I added the interaction variable between cultural distance and prior experience, resulting in model 6. Whereas the coefficient for prior experience in model 5 was significant, the addition of the interaction variable in model 6 led to insignificance for both variables. Also in model 7, which is the full model with all independent variables, no significance is found for both the interaction variable and the variable for prior experience. Based on these findings, I conclude that the third hypothesis is rejected, and that prior experience in a region does not serve as a moderator for cultural distance in understudied countries. Worth noting is that the R-squared of the full model, which is model 7, is actually lower than in model 4.

5. Discussion

The aim of this paper was to assess the effect of cultural distance on subsidiary performance in understudied countries. Whereas a negative effect was expected based on the literature on more studied countries, it was also expected that the effect was harder to overcome in these understudied countries. The premise was that in such countries institutions are generally speaking of lower quality than in Western countries that are more often the subject of studies, and that therefore one might expect that cultural differences are harder to overcome.

In order to compare the relationship in such understudied countries to the more studied countries, I ran the regression on multiple samples. The sample of understudied countries showed a negative coefficient, implying that cultural difference hurts subsidiary performance. However, since the coefficient is not significant, I cannot draw any conclusions and also cannot reject the hypothesis that there is no effect here. For the full sample and sample of non-understudied countries, the results were also insignificant, although these models showed a positive coefficient. This result is unexpected, seeing how most of the literature points towards cultural difference having a negative effect. With the lack of significance for the coefficient for understudied countries, the first hypothesis of this thesis is rejected. A potential explanation for this lies in a combination of the arguments that find evidence in favor and against this hypothesis in the literature. Amongst others, Dikova et al.

(2016) argue that cultural distance creates complexity and uncertainty and that these obstacles hinder performance. Morosini et al. (1998) argue that there might be learning across the different cultures and that capabilities can be transferred, leading to better performance. Finding no significant result in this thesis for the first hypothesis might be a result of those arguments being offsetting for the MNEs in this dataset. Another explanation might lie in the thought that there is a confounding variable that is not controlled for, driving the coefficient towards zero, which is an argument also provided by Tihanyi et al. (2005).

For the second hypothesis, I expected institutional quality of a country to have a moderating effect. Since institutional theory states that institutions are there to help overcome obstacles such as cultural differences, stronger institutions might be more helpful in this overcoming, while weaker institutions might be incapable of such help. The interaction variable for this moderating effect was significant and positive in both the model with the highest R-squared, as in the most comprehensive model. Based on this positive and significant coefficient, the second hypothesis is not rejected and there is evidence that institutional quality does indeed serve as a moderator for cultural difference.

For the third hypothesis, I expected prior experience in the region of the host country to have a mediating effect as well. From the theory of organizational learning, one can expect a firm to do better in an environment that it is already familiar with. The coefficient for the moderating effect was insignificant in all instances. Therefore, I reject the third hypothesis. This was not in line with most literature (Shenkar, 2001; Popli et al., 2016 for example) but was in line with Li et al. (2014). One explanation could be that cultural differences might be so deeply embedded that the 'liability of outsidership' cannot be overcome, despite such experience, similar to what Li et al. (2014) argue.

The aim of this thesis was to contribute to the academic literature in two ways. First, it aimed to research the effects of cultural differences in these understudied countries and see whether those were different than in the Western, more studied countries. In this thesis, all the results for cultural difference are insignificant, both for more studied as understudied countries. This in line with Tihanyi et al. (2005), who also found no significant result, but goes against Morosini et al. (1998), who found a positive effect of cultural distance on performance, and against a large majority of literature that finds a negative effect (among other Ahammad & Glaister, 2011; Mulok & Ainuddin, 2010; Beugelsdijk et al, 2018).

However, finding no result, is a result in itself. Such a contrasting finding makes way for the argument that more research on this topic needs to be done to address this ambiguity, and the special place that these understudied countries have should not be overlooked.

The second contribution was to be made on the role of institutional quality in overcoming cultural distances. The reasoning was that stronger institutions would be capable enough to help out subsidiaries from foreign firms and thereby decrease the discriminatory effects and uncertainty foreign firms face, in contrast to weaker institutions. This thesis finds significant support for this hypothesis, with coefficient being significant on the 5 and 10%-level. This also means that in these understudied countries, where institutional quality tends to be lower, overcoming cultural distance might be harder than in Western countries. This hypothesis has not been largely tested in the academic literature, whereas there seems to be a role for institutions when it comes to cultural distance, as proven in this thesis. For further research on cultural distance, researchers should acknowledge the role of institutional quality, and take it into account when analyzing effects.

A few caveats of this thesis have to be addressed. The first caveat is about the interpretation of the results. The model with the highest R-squared was just above 40 percent, meaning that about 60 percent of variance in the subsidiaries' performance was unexplained. Therefore, there could be confounding variables that were not in the model. When addressing the relationship between subsidiary performance and cultural differences, one needs to be careful and not merely speak of a completely causal effect, for the reason described above. Another caveat of the analysis provided in this thesis is that the cultural difference, quantified by the Hofstede index, is a time-invariant variable, meaning that the value is constant over years. This is in contrast to the subsidiary performance, measured by its Return on Assets, which is actually time-variant. As a result, the Hofstede-index used for cultural difference is unable to account for the variance in the dependent variables over time, but merely between countries and firms. This also weakens the explanatory power of the model.

As discussed in the introduction, this thesis' purpose was to research whether effects of cultural difference were similar in understudied countries. While the effects for these understudied countries were insignificant for both samples, an interacting effect was found for cultural distance and institutional quality. With understudied countries having lower

institutional quality on average, the main argument still stands: We cannot simply assume that effects of cultural distance are similar in all countries across the world. Managers of multinational enterprises need to consider the different contexts in these understudied countries when considering going abroad and acknowledge that cultural differences might be harder to overcome in such countries, even if no direct effect was found. I urge other researchers to use different datasets and to look at the relationship between cultural distance and performance in the understudied countries, to create more of an academic consensus about the relationship in this context. This will not only fill the void in the academics of international business when it comes to understudied countries, but also create a better picture for managers of multinational enterprises.

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Appendix

Appendix 1: List of all countries distinguished by Fainshmidt et al. (2018) as understudied.

Algeria	Czech Republic	Kenya	Philippines	Taiwan
Angola	Egypt	South Korea	Poland	Tanzania
Argentina	Estonia	Kuwait	Qatar	Thailand
Azerbaijan	Ethiopia	Latvia	Romania	Tunisia
Bahrain	Georgia	Lebanon	Russia	Turkey
Bangladesh	Ghana	Lithuania	Rwanda	Uganda
Belarus	Hong Kong	Malaysia	Saudi Arabia	Ukraine
Botswana	Hungary	Mexico	Senegal	UAE
Brazil	India	Mongolia	Singapore	Venezuela
Bulgaria	Indonesia	Morocco	Slovakia	Vietnam
Cameroon	Iran	Namibia	Slovenia	Yemen
Chile	Israel	Nigeria	South Africa	
China	Jordan	Pakistan	Sri Lanka	
Colombia	Kazakhstan	Peru	Sudan	

*Appendix 2: List of countries in the Orbis-database. Countries marked with a * are considered as understudied by Fainshmidt et al. (2018). Bhutan, Botswana, Sri Lanka, Nepal and Oman were not part of the Hofstede-database and were therefore dropped from analysis. Kenya and Mauritius are considered as part of West-Africa, in order to make them compatible with the Hofstede-database.*

Argentina*	China*	Ireland	Malaysia*	Singapore*
Australia	Colombia*	Iceland	Nigeria*	Slovakia*
Austria	Cyprus	Israel*	Netherlands	Sweden
Belgium	Czech Republic*	Italy	Norway	Thailand*
Bangladesh*	Germany	Japan	Nepal	Tanzania*
Bulgaria*	Denmark	Kenya*	New Zealand	Uganda*
Bosnia and Herzegovina	Spain	Korea (South)*	Oman	U.S.A.
Brazil*	Finland	Sri Lanka*	Philippines*	Vietnam*
Bhutan	France	Luxembourg	Poland*	South-Africa*
Botswana*	Great-Britain	Morocco*	Puerto Rico	Zambia
Canada	Greece	Mexico*	Portugal	
Switzerland	Hungary*	Malta	Romania*	
Chili*	Indonesia*	Mauritius	Russia*	

Appendix 3: Descriptive statistics for the relevant variables in this thesis for the full sample

Variable	Obs	Mean	Std. Dev	Minimum	Maximum
<i>Subs. ROA</i>	3980	1.53899	19.87618	-99.95	99.35
<i>Firm ROA</i>	3982	9.305726	10.98917	-120.0248	129.0847
<i>Hofstede</i>	4020	1.622415	0.5769712	0.374009	6.370975
<i>GDP capita</i>	4020	35594.89	15046.77	285.9642	112028.6
<i>Firm size</i>	4020	13.70521	30.74637	0	222.993
<i>Same industry</i>	4020	0.4154229	0.4928561	0	1
<i>Subs. Age</i>	3935	12.84828	14.80362	0	121
<i>Inst. Qual.</i>	4020	3.7045	0.6494174	1.34455	4.532239
<i>Experience</i>	4020	0.5106965	0.4999478	0	1

Appendix 4: Descriptive statistics for the relevant variables in this thesis for the sample of understudied countries

Variable	Obs	Mean	Std. Dev	Minimum	Maximum
<i>Subs. ROA</i>	713	2.068794	19.57377	-83.67	93.38
<i>Firm ROA</i>	717	9.10511	10.04606	-60	67.3173
<i>Hofstede</i>	720	1.110097	.631389	.374009	4.645121
<i>GDP capita</i>	720	13346.82	13037.35	285.9642	54007.3
<i>Firm size</i>	720	18.85879	37.04705	0	222.933
<i>Same industry</i>	720	.5291667	.4994956	0	1
<i>Subs. Age</i>	673	10.57548	11.96435	0	59
<i>Inst. Qual.</i>	720	2.610549	.656624	1.34455	3.796668
<i>Experience</i>	720	.584722	.4931124	0	1