



Because Location Matters: What Multinationals Must Know About Cultural Distance

AREA: 2
TYPE: Application

Porque la localización es importante: Lo que las multinacionales deben saber acerca de la distancia cultural

Porque a localização conta: O que as multinacionais devem saber sobre a distância cultural

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The purpose of this paper is to analyse the influence of cultural distance on the ownership level assumed when international markets are targeted, and how managers are more likely to change their mind when they take into account the moderating effect of country risk. To this end, we have reviewed the pertinent literature as well as several Spanish case studies. The statistical verification has been performed by a Tobit model over the Spanish manufacturing sector (2000–2005). The results support our assumptions about the effect that cultural distance and country risk have on the commitment level and allow us to reconcile the two opposite streams that scholars have defended before.

El objetivo de este artículo es analizar la influencia que tiene la distancia cultural sobre el nivel de compromiso asumido en los mercados internacionales y cómo los directivos son más propensos a cambiar el sentido de esta decisión cuando tienen en cuenta el efecto moderador del riesgo país. Con este fin hemos revisado la literatura pertinente, así como diferentes casos españoles. El estudio empírico ha sido realizado con un modelo Tobit sobre una muestra representativa del sector manufacturero español (2000–2005). Los resultados contrastan positivamente nuestras hipótesis acerca del efecto que la distancia cultural y el riesgo país tienen sobre el nivel de compromiso y nos permite reconciliar dos vertientes de trabajos que, tradicionalmente en la literatura, han estado enfrentados.

O objetivo deste trabalho é analisar a influência da distância cultural no nível de propriedade assumido quando o alvo são os mercados internacionais, e como é mais provável que os gestores mudem a sua perspectiva quando levam em conta o efeito moderador do risco de país. Para tal, passámos em revista a literatura pertinente bem como vários estudos de caso espanhóis. A verificação estatística foi efectuada com um modelo Tobit sobre o sector industrial espanhol (2000–2005). Os resultados confirmam os nossos pressupostos sobre o efeito que a distância cultural e o risco de país têm no nível de empenho e permitem-nos conciliar as duas correntes opostas que os académicos defenderam anteriormente.

DOI
10.3232/
GCG.2009.
V3.N3.02

1. Introduction

Facing a complex and globalized environment, characterised by instability and uncertainty, companies are forced to enter foreign markets, where opportunism is possible and knowledge is imperfect (Che and Facchini, 2009).

Furthermore, having decided to serve a foreign market, the choice about the degree of implication abroad acquires special significance in regards to its potential success (Young *et al.*, 1989; Schäfer, 2002; Reus and Lamont, 2009).

In doing so, we must bear in mind that there are multiple factors which affect the internationalization process, but, in studying them, we must highlight the very important role played by cultural distance. Moreover, several studies state that this factor is a powerful determinant in the choice related with the ownership level (Contractor and Kundu, 1998). In this vein, Hutzschenreuter and Voll (2008) have given more arguments. They state that cultural distance affects negatively company performance because there are limits to the amount of complexity that a firm is able to manage. Specifically, Wang and Schaan (2008) state that, when cultural distance increases, learning, acculturation and transfer of home-based management become more difficult; and that is the fact because foreign subsidiaries are more likely to fail. For those reasons, the cultural distance between the home country and the host one, should be carefully analyzed in order to choose the best level of ownership and, doing so, increase the probability of company success.

Notwithstanding, the effect of cultural distance on ownership commitments is ambiguous from a theoretic point of view. Even more, we may find mixed empirical results about this topic (Tihanyi *et al.*, 2005). For a review of examples of these contradictions see Table 1.

Table 1. Prior studies on ownership level using cultural distance

Study	Level of Ownership	Home Country	Host Country	Empirical Results
Kogut and Singh (1988)	Acquisition, Greenfield, JV	14 countries (UK, Japan, Canada, and 11 mostly Western Europe)	USA	Positive to JV, signif.
Erramilli (1991)	Export, contract, FDI	USA	Not specified, more than 10 countries	CD as control variable
Shane (1992)	Licensing vs. FDI	USA	33 countries	CD as control variable
Erramilli and Rao (1993)	Shared vs. full	USA	Not specified	Negative to full control, signif.

1. According to the UNCTAD (2006) foreign direct investment (FDI) has grown notably on average at 13.5% per year between 1986 and 2005.

KEY WORDS

International Business, Cultural Distance, Country Risk, Tobit Model, Zero-truncated Negative Binomial Regression

PALABRAS CLAVE

Negocio internacional, Distancia cultural, Riesgo país, Modelo Tobit, Regresión binomial negativa de truncación en cero

PALAVRAS-CHAVE

Negócio Internacional, Distância Cultural, Risco de País, Modelo Tobit, Regressão Binomial Negativa de Truncagem Zero

JEL CODES

F200; F230

Agarwal (1994)	JV vs. sole venture	USA	20 countries (with Japan, UK, Canada, France, Germany, Italy mainly represented)	Positive to JV, signif.
Shane (1994)	Licensing vs. FDI	USA	33 countries	CD as control variable
Cho and Padmanabhan (1995)	Greenfield vs. acquisition	Japan	45 countries	Negative to acquisition, insignif.
Erramilli (1996)	Sole vs. joint	USA/Europe	Not specified	Insignif.
Padmanabhan and Cho (1996)	Full vs. shared	Japan	36 countries	Positive to full ownership, signif.
Pan (1996)	Majority vs. minority	USA (549), Japan (338), Europe (220), Hong Kong (2732), others	China	Positive to majority ownership, signif.
Erramilli et al., (1997)	Full vs. shared	Korea	Not specified (both developed/ developing countries)	Positive to full ownership, signif.
Anand and Delios (1997)	Acquisition, Greenfield, JV	Japan	East & SE Asia, Western Europe, North America	CD as control variable
Barkema and Vermeulen (1998)	Start-ups vs. acquisition	Netherlands	72 countries	CD as control variable
Contractor and Kundu (1998)	Management service contract, franchising, partial ownership, full ownership	Not specified	Not specified	Negative to high equity ownership, insignif.
Hennart and Larimo (1998)	Shared equity vs. wholly owned subsidiary	Japan/Finland	USA	Positive to shared ventures, signif.
Padmanabhan and Cho (1999)	Shared vs. full	Japan	45 countries	Positive to shared, insignif.
Arora and Fosfuri (2000)	Licensing vs. WOS	North America (68), Japan (32), Western Europe (53)	60 countries	Negative to WOS, signif.
Brouthers and Brouthers (2000)	Acquisition vs. Greenfield	Japan	UK, France, Netherlands, Germany, Belgium, Luxembourg	Negative to Greenfield, insignif.

Chang and Rosenzweig (2001)	Greenfield, acquisitions, JV	Japan, UK, Germany, Switzerland, France, Italy, Belgium, Norway, Sweden, Denmark, Finland	USA	Positive to greenfield, signif.
Luo (2001)	JV vs. WOS	USA, Hong Kong, Japan, Germany, Singapore, France, UK, Italy, Taiwan, Australia, Canada, Korea	China	CD as control variable
Meyer (2001)	Shared vs. full	Britain, Germany	Czech Republic, Hungary, Poland, Russia, Rumania	Positive to shared, signif.
Chen and Hu (2002)	Contractual JV, equity JV, and WOS	Not specified	China	Positive to WOS (over JV), signif.
Harzing (2002)	Greenfield vs. acquisition	USA, UK, Germany, France, Sweden, Finland, Netherlands, Switzerland	22 host countries	CD as control variable
Pak and Park (2004)	Shared vs. full	Japan	Unclear 37 countries due to data unavailability for 24 nations (out of the population of 61 nations)	Positive to shared, signif.
Cho and Padmanabhan (2005)	Shared vs. full	Japan	45 countries	Positive to full when moderated by firm experience (esp. decision-specific), signif.
Tihanyi et al. (2005)	Various (capital invested, equity position, level of control in JV, acquisitions, Greenfield)	Various	Various	No significant relationship

Source: Kim and Gray (2009:58-59)

JV: Joint Venture
WOS: Wholly Owned Subsidiary
CD: Cultural Distance

In view of the table, we can observe the different results that cultural distance offers in regards to its effects on the ownership level. Little has been said about these divergences; furthermore, when we observe the studies carried out before, we observe that there is no research applied to the Spanish case. These facts emphasises the relevance of studying

them, in order to clarify the opposing arguments that have been sustained thus far from the point of view of a new location, Spain.

The purpose of this paper is to fill the gap mentioned before by focusing on the role that moderating variables can introduce in the topic. So, we state that all the divergences may be related to one moderating variable, country risk.

So, we study the effect that this variable exerts over cultural distance and how, depending on the result of their interaction (cultural distance and country risk), managers are more likely to change the foreign ownership decision.

The remainder of the paper is organized as follows: next, we present the theoretical basis of the study, by reviewing the concept of cultural distance and its relativity; moreover, attempting to reconcile the two opposite streams that scholars defend about the link between cultural distance and ownership level in foreign subsidiaries, we introduce a moderating variable -country risk- which enables us to comprehend the complexity of the decision and how the interaction between those factors can change manager's mind. Additionally, all our arguments are accompanied by Spanish case studies. In sections 3 and 4 we develop a model to study the degree of commitment by a foreign multinational in a new market; and we will check its relevance by means of the Survey of Business Strategies (SBSS), which gathers a sample of 1248 observations of companies in the Spanish manufacturing sector during the period 2000-2005. Through a Tobit model and a Zero-truncated negative binomial regression, the effect of cultural distance on the chosen type of ownership level will be determined and its interaction with country risk will play a very relevant role. Concluding, section 5 compiles several conclusions that every manager should take into account before taking ownership decisions.

2. Theoretical Basis of the Study

2.1. What does cultural distance mean?

There is a great conceptual divergence in the literature about its definition and, furthermore, there are other analogous concepts, such as *geographical*, *geocultural* and *psychic distance*² that make it more confuse. In our case, we will understand cultural distance to be *"the factor which encompasses cultural differences between the home country and the host one, in relation to doing business and all the contingencies of the host country which hinder good understanding and the development of business transactions and agreements"* (Almodóvar, 2007). The way we define cultural distance allows us to see its relativity. So, the higher or lower degree of cultural distance will depend, firstly, on the internal characteristics of the multinational enterprise (MNE) in the home country; and, secondly, on its host environment.

2. For a deeper review: Sousa and Bradley (2008).

Regarding its internal characteristics, cultural distance will depend on the prior knowledge about the host country. This means that the wider the prior knowledge about the country's culture, the smaller the cultural distance we will be subject to. The relativity of the concept can be observed in the family run business SACHA LONDON Ltd. This Spanish footwear company is located in four continents and, from its origin dated back almost half a century ago, Sacha London was born as an international company. Through a personal interview, they explained us how their main purpose was the design of high quality customized shoes for every different market, that goal assumed a high degree of adaptation and a deep knowledge of host countries. So, in order to manage the international process to large cultural distance countries, a cosmopolitan business man was hired. He was born in Morocco; he had a wide working experience in Canada, and a wide range of friends from all around the world. This person was the key for avoiding cultural distance problems in the Arab World and North America. In the same way, when the company decided to establish a shoe factory in China, he could avoid all the cultural problems thanks to his Chinese partner, a former friend from Canada who was born in Hong Kong. In that way, we can observe how relative the cultural distance is depending on the international knowledge that the company has.

On the other hand, when we have not the specific international knowledge needed to invest abroad, we must take into account "external" aspects; in that way, some of the components which make up cultural distance directly depend on exogenous factors located in the environment (characteristics of the country being targeted, those practises and regulations which are generally accepted in that particular activity sector...) Therefore, the less divergent these attributes are, the smaller the cultural distance will be. Following the former case, Sacha London had to rule out the establishment of a shoe factory in the Russian market. They had neither the knowledge nor the networking for avoiding the regulation problems related to this market. So, after several attempts they had to cancel the project because the regulations were so different from the Spanish ones that they cannot manage them by themselves.

2.2. What is the link between Cultural Distance and Ownership level?

The most widely used approaches in analysing the effects of cultural distance on the entry mode are: the theory of organisational capacities and the internalisation theory³.

According to **the organisational capacities theory** –which focuses on the problem of the transmission of knowledge between companies located in different countries–, when we transfer knowledge we must take into consideration people responsible for its decoding in the host country, such that the greater the differences between both countries at the language and social levels, the greater the likelihood that the transmission does not take place successfully (Kogut and Zander, 1993). For this reason, Madhok (1997) argues that the applicability of organisational capacities in countries with a large cultural distance is undermined by the lack of specific knowledge about the market being targeted; in order to overcome this disadvantage, they recommend modes which do not imply full control, preferably options that entail cooperation with a foreign company; that is to say, a lower level of ownership.

3. Rugman (1986) calls the Internalisation theory the theory of Transaction Costs and the Multinational Enterprise and, in his work, uses both terms interchangeably. Hill and Kim (1988) also refer to this fact. Therefore, both theories will be considered to be equivalent.

That is the case of NUTREXPA GROUP, a Spanish leading food company created in 1940 and present in almost the entire world over the five continents with brands like: Cola Cao (Gao-le-Gao in China), Granja San Francisco Honey and Pâtés La Piara. This company has 3 main subsidiaries located in Portugal, Chile and China (the rest of countries are treated as export markets). Its investment pattern followed the behavior proposed by the organizational capabilities framework where Portugal and Chile –with a small cultural distance with respect to Spain following Hofstede’s index and the dual indicator used in this study- were subject of the highest level of ownership; and China –with a large cultural distance following the same criteria- was subject of a smaller one through a joint venture⁴.

In support of this alternative, papers use arguments related with the fact that companies which invest in culturally distant countries will prefer a lower ownership degree and cooperate with a local company in order to speed up the learning process, increase the local knowledge and reduce the uncertainty (Gatignon and Anderson, 1988; Erramilli and Rao, 1990). So, through a share participation in the local subsidiary companies are capable of promoting knowledge in those critical areas where it is insufficient and cannot be developed under adequate conditions, due to its high monetary cost or time consumption (Madhok, 1997) or the loss of value in the transfer thereof (Erramilli *et al.*, 2002). Therefore, the shared participation provides the necessary structural mechanism to enhance and exchange the flow of knowledge between the parent company and the local company (Davies, 1977; Killing, 1983; Kogut, 1988; Madhok, 1997), whilst making it possible to solve the problem of managing local workers, relations with vendors, buyers and the government through the delegation of powers to the local partner (Hennart, 1988; Kogut and Singh, 1988; Hennart and Larimo, 1998). Therefore:

Hypothesis 1: The impact of cultural distance on the level of foreign ownership is negative.

According to the **internalisation theory** –which focuses on the transaction costs arising from operating in international markets- as cultural difference between two countries increase, so do the associated transaction costs; therefore, the company will choose to internalise operations in order to minimise them –higher degree of ownership- (Hennart and Reddy, 1997). That is the case followed by IMAGINARIUM INC., one of the largest specialized toy retail companies in the world with shops in 28 countries and founded at 1992. This company installed its manufacturing factory in Hong Kong with a 99.99% of participation. This level of implication was due to several reasons mentioned by its CEO Félix Tena. He explained that there is a great knowledge cluster in Asia where developers, engineers and die-shop workers are located, so there are all the skills and capabilities needed. At the same time, this part of China is a former English colony where both cultures are mixed but, it has a European regulation that facilitates everything although they have a Chinese taste. And, finally he recognized that the ownership of the factory in Hong Kong contributes for lowering costs.

In support of this alternative, we find articles such as Anand and Delios’ (1997), which defend the highest level of ownership through the full acquisition of a local company in order

4. We must point out that, when Nutrexpa Group was established in China, they had no options other than taking a Chinese partner; but, the company has recognized that this legal duty didn’t imply a change in their minds because they had the intention of entering China with a partner anyway.

to absorb all of its knowledge. Since knowledge is a good in relation to which the market functions inefficiently, the risk of opportunism is very high. For that reason, the company will choose to internalise this specific good through the acquisition of the foreign company; the company will thus be able to absorb the external uncertainty through the centralisation of decision-making and to protect against opportunistic behaviours (Sutcliffe and Zaheer, 1998; Brouthers and Brouthers, 2001).

In the literature on the subject we find other arguments that confirm this pattern. This is the case of Bivens and Lovell (1966), who suggest that, in the face of cultural distance, organisations react by demanding ownership thereof such that they may implement their operating methods without any type of restrictions. These companies do not trust the foreign partners' local management and prefer to control the entire process themselves in order to be able to execute actions following their own guidelines. This position is defended in Erramilli et al.'s work (2002), which notes the possibility that companies facing a large cultural distance may prefer to fully internalise the transfer of their resources and capacities. Therefore:

Hypothesis 2: The impact of cultural distance on the level of foreign ownership is positive.

Thus, we can observe that we cannot establish a single relationship between cultural distance and ownership level. Even more, if we revise real patterns of internationalization followed by Spanish companies we realize how the dual behaviour is found inside the same company. For example, ZARA (one of the sales formats of INDITEX GROUP, founded in Spain in 1975, and one of the largest fashion distribution groups present in 73 countries). The business model of Zara has a global preference for high levels of ownership all around the world (EEUU, Hong Kong) due to the logic cited before by Bivens and Lovell (1966) and Erramilli et al. (2002). In that way, Grimpe and Sofka (2007) explain how Zara is able to overcome competition based on price/cost advantages through, what they call rapid response capabilities and, doing so, Zara's customers can expect new items every week with an average lead time from design to store delivery of only three weeks. For that reason, in order to preserve its innovative system, which has successfully turned the predominant industry logic upside down, Zara needs a high degree of ownership for controlling completely its production and distribution value chain. But, recently we can observe several exceptions for this rule. So, we can find shared ownership in countries like India where Inditex Group has announced the launch of a joint venture with the Trent Limited Group Tata to introduce Zara shops in 2010 (51% Inditex; 49% Tata). Even more, we can find four cases where Zara does not want to commit their resources, so it has opted for a franchise model in Russia, Scandinavian countries, Near East and Egypt. We must mention that, in Spain and the rest of countries, it is absolute impossible to obtain a licence for establishing a franchise. The main point of this argument is that we have several countries (EEUU, Hong Kong, India, Russia, Egypt...), and all of them characterized by a large cultural distance with Spain but, the behaviour followed by Zara is not the same.

In this direction, we can study the case of BORGES GROUP; one of the main Spanish world operators of the Mediterranean diet food. This company, founded in 1896, has expanded its business project around the five continents. Following the organizational capabilities framework, the larger the cultural distance, the lower ownership level the company will have. In that way, when they decided to establish branches in Morocco and Jordan, which implied a large cultural distance levels, they assumed a lower level of ownership through a 70% and a

55% of participation respectively. Notwithstanding, when Borges group decided to run up a subsidiary in Australia (a large cultural distance country from the point of view of Hofstede's index and from the dual indicator applied on the empirical aspects of this paper) they assumed the highest level of ownership and control (100% of participation) as the internalization theory proposes.

Thus far, we have seen two opposite views regarding the effect of cultural distance on the behaviour of companies; even inside the same company we can find the controversial paradox. For that reason, we have attempted to research deeper about this duality. In the literature, we find a few studies with this purpose; for instance, Agarwal (1994) analyses why, considering that shared ownership is the option that researchers most often support in the face of a large cultural distance, there are companies that choose full ownership, and suggests that the reason is the presence of moderating variables which alter the result of the investment.

Subsequently, Brouthers and Brouthers (2001) empirically supports what Agarwal (1994) had already attempted, proving the importance of the moderate variable investment risk. Therefore, we can see that various studies have tried to explain the contradictions in the relationship between cultural distance and the ownership level, by including moderating variables in the analysis, primarily those related to the investment risk in the foreign country. So, taking into account this fact, and observing the differences between the countries targeted by Spanish companies in the mentioned examples, we have decided to include in our research a moderate variable, the selected one has been: **country risk**. The significance of studying this factor is based on the assumption that imbalances in the economic, social and political factors increase the investment risk, jeopardising the business results (Meldrum, 1999; McGowan and Moeller, 2003).

For this reason, when companies target countries characterised by a high country risk, they will seek ownership levels that allow them, if necessary, to leave the country without suffering substantial losses (Hill et al., 1990; Pla Barber and León Darder, 2001), that is, they will seek a low commitment of resources (Contractor, 1984; Anderson and Gatignon, 1986; Kim and Hwan, 1992; Zhao et al., 2004).

Summing up all the arguments mentioned above and adding the country risk effect over the final decision, we can assume that companies which establish a subsidiary in large cultural distance countries, but without any country risk associated, will chose high ownership levels. As it is proposed in the hypothesis H.2 and followed by the aforementioned companies. We have observed how companies like Zara, Borges or Imaginarium used high levels of commitment when they located their subsidiaries in EEUU, Australia and Hong Kong (countries characterized by a large cultural distance but a low country risk). However, the former behavior seems to change when the target country is subject of a high country risk, as well as a large cultural distance. That reason could explain why companies like Imaginarium, Nutrexpa, Zara or Borges decided to have lower levels of ownership when they targeted countries like China, Russia, Egypt, India, and Morocco (which are characterized by a large cultural distance and a high country risk at the same time). Therefore:

5. The moderating variables analysed in Agarwal (1994) are international experience, technological complexity, size of the company, country risk and market potential.

Hypothesis 3: The impact of cultural distance on the level of foreign ownership is negatively moderated by country risk.

3. Study Methodology

Previously, we have tried to illustrate our hypothesis through cases of several manufacturing Spanish firms. In this section, we are going to support our study through a quantitative analysis. In order to build a model in line with the theoretical arguments, we are going to use an annual survey conducted by the Fundacion SEPI in conjunction with the Spanish Ministry of Industry. This survey, named SSBS -Spanish Survey of Business Strategies-, samples yearly a representative panel of Spanish manufacturing firms. The sample includes information on 1870 firms from 20 industries (see Table 2 for breakdown by industry).

Table 2. Industry breakdown of the full sample

Industry	Number of firms						Percentage of total (%)					
	2000	2001	2002	2003	2004	2005	2000	2001	2002	2003	2004	2005
1. Meat products	50	45	44	38	38	48	2.67	2.61	2.58	2.75	2.77	2.51
2. Food and tobacco	173	150	158	128	128	171	9.25	8.7	9.25	9.28	9.32	8.95
3. Beverages	31	26	26	20	20	43	1.66	1.51	1.52	1.45	1.46	2.25
4. Textiles and clothing	180	161	160	117	114	157	9.63	9.34	9.37	8.48	8.3	8.22
5. Leather and footwear	54	49	48	31	31	50	2.89	2.84	2.81	2.25	2.26	2.62
6. Wood and wood products	64	57	58	46	46	66	3.42	3.31	3.4	3.33	3.35	3.45
7. Paper and publishing	60	56	57	46	45	57	3.21	3.25	3.34	3.33	3.28	2.98
8. Edition and graphic arts	104	96	98	78	77	101	5.56	5.57	5.74	5.65	5.6	5.29
9. Chemical products	116	108	105	90	89	132	6.2	6.26	6.15	6.52	6.48	6.91
10. Rubber and plastic products	108	102	102	77	78	93	5.78	5.92	5.97	5.58	5.68	4.87

11. Non-metallic products	126	116	114	98	97	150	6.74	6.73	6.67	7.1	7.06	7.85
12. Ferrous and non-ferrous metals	64	60	60	54	55	63	3.42	3.48	3.51	3.91	4	3.3
13. Metallurgy and metallic products	190	193	189	157	156	239	10.2	11.2	11.1	11.4	11.4	12.5
14. Agricultural machinery	139	128	125	107	107	135	7.43	7.42	7.32	7.75	7.79	7.06
15. Office products and data processing	25	26	21	15	15	30	1.34	1.51	1.23	1.09	1.09	1.57
16 Electrical accessories and materials	117	109	102	78	78	109	6.26	6.32	5.97	5.65	5.68	5.7
17 Automobiles and motors	102	92	91	72	72	96	5.45	5.34	5.33	5.22	5.24	5.02
18 Transport material	39	32	33	28	28	48	2.09	1.86	1.93	2.03	2.04	2.51
19 Furniture products	94	84	84	75	75	90	5.03	4.87	4.92	5.43	5.46	4.71
20 Miscellaneous Manufacturing	34	34	33	25	25	33	1.82	1.97	1.93	1.81	1.82	1.73
Total	1870	1724	1708	1380	1374	1911	100	100	100	100	100	100

Of particular interest for this research, beginning in the year 2000 the Fundación's survey included detailed questions concerning foreign direct investment activities, which are particularly relevant to the above hypotheses. We therefore use the survey data from years 2000-2005 to test our hypotheses. All the information included is subjected to validation and logical consistency controls by Fundación SEPI.

Summarizing, we work with the SBSS whose population of reference is made up by firms with 10 or more employees and which belong to the manufacturing industry. The geographical scope of reference is all the Spanish territory, and the variables have a yearly temporal

dimension. This dataset allows us to compel the largest sample for any research on international Spanish firms. Table 3 summarizes sample size.

Table 3. Sampling boundaries

Number of Observations for the 2000-2005 Period
24.300 firm observations collected globally in the SSBS
9.967 firm observations in the live simple of the SSBS
1248 observations* in the SSBS by firms with participation in companies located abroad

*We have used a pooled cross-section just to get a bigger sample size in order to obtain more precise estimators (Wooldridge, 2003). So, we will investigate the effect of time through adding a time variable directly -Year-.

3.1. Measures

a) Dependent Variable

In order to contrast our model, we use as dependent variable *Foreign_Ownership* that contains the information provided by the survey about the percentage of participation in companies located abroad.

b) Independent Variables

Cultural Distance

The most widely used model to measure cultural distance -*Cultural_Dist*- is the one proposed by Hofstede (1980, 2001). In the analysis we have conducted, we have chosen to discard the Hofstede index due to the lack of consistency with our study. The main reason is because the study is limited to certain countries and our sample of Spanish manufacturing companies targets a total of 46 different countries, of which 11 are not classified in the Hofstede index and several of them cannot be approached by calculating the arithmetic mean of the surrounding countries⁶. Other possible measures are the ones developed by Schwartz (1994, 2003) and GLOBE (House *et al.*, 2004). Unfortunately, we have the same problem here because we have international activities in countries that are not studied in their researches. Furthermore, none of them include any criterion referred to business practices.

For the reasons mentioned above, we will use double criteria –an economic and a linguistic one- to measure *Cultural_Dist* between Spain and the countries where the subsidiaries are located. We will assume small cultural distance when host countries are inside the European Union because all of them had to fulfill the Maastricht convergence criteria (which are a good fit for similarities in business practices); or, all those host countries which share with Spain the same linguistic distance according to the index developed by West and Graham (2004). Otherwise, it will be large cultural distance.

6. In some cases, because they are islands (Cuba, Republic of Trinidad and Tobago), in other cases because part of the data are missing (Bolivia, Bulgaria, Romania), and in others because practically all the data are missing (Morocco, Russia, Tunisia, Ukraine).

Interaction of Cultural Distance and Country Risk

The value of this factor - *Cultural_Dist&Country_Risk*- is the multiplication of the former variable *Cultural_Dist* and a new one, country risk (this variable will be explained in the subsection "Control variables"). *Country_Risk* has been obtained thanks to the information facilitated by Aon Political Risks Services and its political and economic risk maps from 2000-2005.

c) Control Variables

Several other characteristics of a firm may affect that firm's level of ownership commitment. We also use various control variables in order to account for domestic parent firm effects, as well as international subsidiary level effects. So, we control for eight likely effects. Regarding to the first group, we include four new variables. Prior scholarship indicates a relationship between ownership level and firm size (e.g., Filatotchev *et al.*, 2007), this variable is expected to be positively associated with the equity participation taken in the overseas subsidiary, because large firms normally possess greater financial and managerial capabilities that allow them to go international alone (that is, assuming the total investment). We control for firm size by including **LnSize**, which is measured as the natural log of the number of employees. Prior scholarship also indicates a relationship between level of participation abroad and domestic experience (e.g., Almodóvar, 2007; Filatotchev *et al.*, 2008). We control for this by including **Age**, which is measured as the total number of full years between the firm's foundation and 2005. Finally, we include local industry and year dummies to control for unobserved industry and year influences on the level of affiliate ownership. Industry dummies go from **Sector1** to **Sector20** (we classify our sample into 20 different manufacturing sectors that can be observed in Table 2); and year dummies go from **Year00** to **Year05**.

In the second group of control variables, that are related to the international subsidiary and the international activities that the parent company achieves, we include four variables more. Some academics (e.g. Tihanyi *et al.*, 2005) suggest that the international decisions are highly influenced by the environmental uncertainty of the other country. For that reason, we introduce the **Country_Risk** measured by Aon Political Risks Services. So, we use their country risk ratings because they provide an indication of overall levels and types of political and economic risks in more than 200 territories worldwide. The maximum value for this variable is 5 and the minimum value is 1, with higher scores indicating a higher risk. Another important variable [suggested by authors like Almodóvar *et al.* (2009) and Delios *et al.* (2008)] is the subsidiary size -**Ln Subsidiary_Size**- because it could be seen as a proxy of the international investment size. In that way, when the amount of resources needed to set up the new business is very large, the parent company could be not able to assume the full ownership and could need a partner to share economic risk. Hence, we measure this variable as the natural log of the number of employees in the subsidiary. We have created this variable using the employment information in order to avoid the problems related to cross-national research such as different accounting methods (Gatignon and Anderson, 1988; Cho and Lee, 2004).

In addition, Hill *et al.* (1990) conceptualize that foreign level of ownership is determined by strategic variables, as one of the main strategic decisions a parent company has to make is whether to adopt a global or a multidomestic strategy -**International_Strategy**-. Following Harzing (2002) and Connelly *et al.* (2007), companies that follow a global strategy are cha-

racterized by a high standardization focus; while companies that pursue a multidomestic one normally adapt their products to the characteristics of the local market. In this vein, Claver Cortés *et al.* (2000) and Almodóvar *et al.* (2009) identify the international standardization production as a valid proxy for global strategies; and the international customization process as a good one for multidomestic strategies. In our case, the SBSS contains this information. So, when companies state that the majority of their products are custom made to fulfill each customer's individual requirements we will assume a "multidomestic strategy"; and "global strategy" otherwise.

Finally, Slangen and Hennart (2008) found that multinational enterprises prefer to enter culturally distant countries through full ownership commitment, but that this preference is lower when they have little international experience. In the same line, Dikova and Witteloostuijn (2007:1016) state that firms with greater international experience face fewer local knowledge disadvantages; for that reason the need for local partner to ease up liabilities of foreignness decreases and the desire for full ownership increases. In order to control this effect, we will introduce the variable **International_Experience**. Prior scholars have usually used the number of years that the company has been operating abroad. Unluckily, SBSS has not this information. In place of the subsidiary age, SBSS collects information about the previous mechanisms used by the company to gain access to international markets (agents' networks, branches, exporters' associations). So, we have created a measure that present the international experienced gathered by the company through these mechanisms. The survey asks for 3 of them. If the company answered "no" to all of them we will give a 0; if it has responded "yes" to one of them we will give a "1"; if "yes" to two of them we will give a "2" and if the company has answered affirmatively to the 3 mechanisms we will give a "3".

3.2. Empirical Results

Providing a correlation matrix for all exogenous variables used in our empirical tests, we present Table 4. The reason of this table is detecting potential problems of multicollinearity; so, we look at correlation coefficients among the independent variables in the model. Except for the, by definition, high correlation between *Cultural_Dist* and *Cultural_Dist&Country_Risk*, none of the correlations are above the usual threshold (>0.5) indicating the possibility of multicollinearity (Hair *et al.*, 1995). In fact, the highest correlation coefficient (from 0.3 to 0.6) is between the two control variables *Year* and *International_Strategy*, and the only ones above the threshold are the categories *Years00* and *Year01*. Therefore the data set does not seem to involve problems of multicollinearity.

Table 4. Correlation matrix

	1	2	3	4	5	6	7	8	9	10	11
1. Foreign_Ownership	1										
2. Cultural_Dist	-0.0259	1									
3. Cultural_Dist & Country Risk	-0.1977	0.5536	1								

4. Country_Risk	-0.0895	0.0965	0.3998	1							
5. Ln Subsidiary_Size	-0.0977	0.0587	0.0846	0.1022	1						
6. International_Strategy	0.0248	0.0234	-0.0039	0.0577	0.0336	1					
7. International_Experience	0.5078	-0.0285	-0.1254	-0.0249	-0.0312	0.3563	1				
8. Ln Size	0.1891	-0.0621	-0.1171	-0.0065	0.3859	0.033	0.088	1			
9. Age	0.0712	-0.088	-0.065	-0.026	0.1606	0.0369	0.0657	0.1972	1		
10. Sector_1	-0.0407	-0.0799	-0.0442	-0.0382	-0.0826	0.0109	-0.0292	0.0634	0.0354	1	
11. Sector_2	0.0395	0.0013	0.0632	0.0171	-0.061	-0.0174	-0.0133	0.0833	-0.005	-0.0575	1
12. Sector_3	-0.03	0.0717	0.0796	0.0369	0.0377	-0.0223	-0.0776	-0.0262	0.2431	-0.0341	-0.076
13. Sector_4	0.0623	0.2341	0.1946	0.069	-0.0311	0.0144	0.0216	-0.027	0.0013	-0.0341	-0.076
14. Sector_5	-0.0347	0.053	0.0772	0.018	-0.0156	-0.0119	0.0262	-0.0692	0.0075	-0.0148	-0.0329
15. Sector_6	-0.0034	0.0618	0.0638	0.0057	-0.0714	0.0336	-0.0021	-0.1201	-0.1219	-0.0224	-0.05
16. Sector_7	0.1082	-0.0955	-0.0673	-0.1096	0.043	-0.0301	-0.0365	-0.0516	-0.1207	-0.0392	-0.0874
17. Sector_8	-0.0758	-0.0944	-0.0522	0.2758	0.0128	0.0491	-0.0625	0.0772	0.0099	-0.0304	-0.0679
18. Sector_9	0.0612	-0.0743	0.0043	0.0411	0.0991	-0.0018	0.0713	0.0286	0.1398	-0.0575	-0.1282
19. Sector_10	0.0307	-0.0366	-0.0601	-0.0074	-0.086	-0.013	0.0692	-0.0557	-0.1208	-0.035	-0.0781
20. Sector_11	0.0572	-0.0068	-0.0455	-0.1121	0.0757	0.0309	0.0563	0.1344	0.0369	-0.0536	-0.1197
21. Sector_12	-0.0688	0.0877	0.0627	0.0708	0.1557	0.0083	-0.0301	0.0958	-0.0062	-0.0374	-0.0834
22. Sector_13	-0.0526	0.0084	-0.071	-0.1099	-0.1021	-0.0511	0.0308	-0.1215	-0.0842	-0.0413	-0.0922
23. Sector_14	0.0142	-0.0129	-0.0909	-0.0208	0.0053	0.0502	0.0853	-0.1087	-0.0759	-0.0529	-0.1181
24. Sector_15	-0.1323	0.0643	0.1523	0.0234	0.006	0.0071	-0.0585	-0.0188	0.0675	-0.0167	-0.0374
25. Sector_16	-0.0124	-0.048	-0.0642	-0.0819	-0.0389	-0.0254	0.0535	-0.0005	0.0491	-0.0374	-0.0834
26. Sector_17	-0.0985	-0.0317	-0.0124	0.0476	0.0917	-0.0345	-0.0941	0.1873	-0.0651	-0.0341	-0.076
27. Sector_18	0.0307	-0.0068	-0.0234	-0.0497	-0.0634	0.0058	0.0186	-0.0169	0.1408	-0.0136	-0.0304
28. Sector_19	-0.0805	-0.068	-0.055	0.0025	-0.0692	0.0092	-0.1254	-0.0531	-0.0498	-0.032	-0.0714
29. Sector_20	0.0532	0.0859	0.0499	0.0022	-0.0533	-0.0052	-0.035	-0.1462	-0.0244	-0.0304	-0.0679
30. Year_00	-0.0132	-0.0139	-0.0193	-0.0549	-0.0407	-0.6154	-0.2038	-0.0123	-0.0461	0.0046	0.0192
31. Year_01	-0.0177	-0.0152	0.0239	-0.0173	-0.0015	-0.6304	-0.2398	-0.0287	-0.0001	-0.018	0.0026
32. Year_02	0.0222	0.0458	0.0199	-0.0355	0.0087	0.351	0.1186	-0.0096	-0.0169	0.0062	0.0128
33. Year_03	-0.0249	-0.0001	0.0097	0.0325	0.0186	0.3275	0.0973	0.0109	0.0096	-0.0061	-0.0092
34. Year_04	0.015	0.0015	-0.0409	0.0375	0.0112	0.3261	0.1185	0.0114	0.0163	-0.0056	-0.008
35. Year_05	0.0202	-0.0189	0.0052	0.0451	0.0058	0.3141	0.1363	0.0325	0.0418	0.0203	-0.0199

Table 4. Correlation matrix (cont.)

	12	13	14	15	16	17	18	19	20	21	22
12. Sector_3	1										
13. Sector_4	-0.045	1									
14. Sector_5	-0.0195	-0.0195	1								
15. Sector_6	-0.0296	-0.0296	-0.0128	1							

16. Sector_7	-0.0518	-0.0518	-0.0224	-0.0341	1							
17. Sector_8	-0.0402	-0.0402	-0.0174	-0.0265	-0.0463	1						
18. Sector_9	-0.076	-0.076	-0.0329	-0.05	-0.0874	-0.0679	1					
19. Sector_10	-0.0463	-0.0463	-0.0201	-0.0305	-0.0533	-0.0414	-0.0781	1				
20. Sector_11	-0.0709	-0.0709	-0.0307	-0.0467	-0.0816	-0.0634	-0.1197	-0.0729	1			
21. Sector_12	-0.0494	-0.0494	-0.0214	-0.0325	-0.0568	-0.0441	-0.0834	-0.0508	-0.0778	1		
22. Sector_13	-0.0546	-0.0546	-0.0237	-0.036	-0.0629	-0.0488	-0.0922	-0.0562	-0.0861	-0.06	1	
23. Sector_14	-0.07	-0.07	-0.0303	-0.0461	-0.0805	-0.0625	-0.1181	-0.072	-0.1102	-0.0768	-0.0849	1
24. Sector_15	-0.0221	-0.0221	-0.0096	-0.0146	-0.0255	-0.0198	-0.0374	-0.0228	-0.0349	-0.0243	-0.0269	-0.0269
25. Sector_16	-0.0494	-0.0494	-0.0214	-0.0325	-0.0568	-0.0441	-0.0834	-0.0508	-0.0778	-0.0542	-0.06	-0.06
26. Sector_17	-0.045	-0.045	-0.0195	-0.0296	-0.0518	-0.0402	-0.076	-0.0463	-0.0709	-0.0494	-0.0546	-0.0546
27. Sector_18	-0.018	-0.018	-0.0078	-0.0119	-0.0208	-0.0161	-0.0304	-0.0186	-0.0284	-0.0198	-0.0219	-0.0219
28. Sector_19	-0.0423	-0.0423	-0.0183	-0.0279	-0.0487	-0.0378	-0.0714	-0.0435	-0.0667	-0.0465	-0.0514	-0.0514
29. Sector_20	-0.0402	-0.0402	-0.0174	-0.0265	-0.0463	-0.0359	-0.0679	-0.0414	-0.0634	-0.0441	-0.0488	-0.0488
30. Year_00	0.0237	-0.0224	-0.0088	-0.0198	0.0212	-0.0546	-0.0004	0.0177	-0.0111	0.004	0.0474	0.0474
31. Year_01	0.0043	0.0043	0.0234	-0.0221	0.0164	-0.0069	0.0026	-0.0013	-0.0273	-0.0142	0.0165	0.0165
32. Year_02	-0.0051	0.0104	0.0265	0.0272	0.0237	-0.0189	-0.0268	0.0048	0.0024	0.0062	-0.0409	-0.0409
33. Year_03	-0.0104	0.0058	-0.0035	0.0118	-0.0195	0.0262	0.0012	0.0007	0.0092	0.0039	-0.0156	-0.0156
34. Year_04	-0.0097	0.0065	-0.0032	0.0123	-0.0188	0.0269	0.0128	-0.0144	0.0103	-0.0103	-0.0148	-0.0148
35. Year_05	-0.0042	-0.0042	-0.038	-0.0083	-0.0273	0.0327	0.0121	-0.0089	0.0196	0.0111	0.0058	0.0058

Table 4. Correlation matrix (cont.)

	23	24	25	26	27	28	29	30	31	32	33	34	35
23. Sector_14	1												
24. Sector_15	-0.0344	1											
25. Sector_16	-0.0768	-0.0243	1										
26. Sector_17	-0.07	-0.0221	-0.0494	1									
27. Sector_18	-0.028	-0.0089	-0.0198	-0.018	1								
28. Sector_19	-0.0658	-0.0208	-0.0465	-0.0423	-0.017	1							
29. Sector_20	-0.0625	-0.0198	-0.0441	-0.0402	-0.0161	-0.0378	1						
30. Year_00	-0.0389	0.0116	0.004	0.0083	-0.0028	-0.012	-0.0035	1					
31. Year_01	-0.0238	-0.0202	0.0275	0.0345	-0.0044	0.0005	0.0099	-0.224	1				
32. Year_02	-0.0044	-0.0177	0.0062	-0.0051	-0.002	-0.0103	0.0326	-0.216	-0.2212	1			
33. Year_03	0.0238	0.0188	-0.011	-0.0104	0.0023	-0.0002	-0.0098	-0.2016	-0.2065	-0.1991	1		
34. Year_04	0.025	0.0192	-0.0252	-0.0097	0.0026	0.0176	-0.0092	-0.2007	-0.2055	-0.1982	-0.185	1	
35. Year_05	0.0232	-0.0103	-0.0042	-0.0209	0.005	0.0058	-0.0228	-0.1933	-0.198	-0.1909	-0.1782	-0.1774	1

a) Model Specification

The dependent variable in the ownership level is the percentage equity stake taken by the Spanish parent company in its foreign affiliate. Taking into account the nature of the dependent variable (*Foreign_Ownership*), that is a count variable whose values go from 1 to

100, we can observe how all these values are all non-zero, as only companies with foreign investments are included in the sample, but the variable has a right censored point because its maximum value cannot exceed 100%. Indeed, several of the 1248 affiliates are wholly owned subsidiaries; so, OLS assumptions of linearity and normality may be violated and, therefore its estimations would thus give rise to biased and inconsistent estimates (Maddala, 1983; Greene, 2001).

The censored nature of the dependent variable suggests the use of the **Tobit model**, because the dependent variable is constrained to an interval of 1 to 100. So, this will be our principal model. The stochastic model underlying Tobit may be expressed by the following relationship (McDonald and Moffitt, 1980):

$$Y_t = x_t\beta + u_t > 0 \\ = 0 \text{ if } x_t\beta + u_t \leq 0 \quad t = 1, 2, \dots, N$$

where N is the number of observations, Y_t is the dependent variable, x_t is a vector of independent variables, β is a vector of unknown coefficients, and u_t is an independently distributed error term assumed to be normal with zero mean and constant σ^2 . Thus, the model assumes that there is an underlying, stochastic index equal to $(x_t\beta + u_t)$ which is observed only when it is positive, and hence qualifies as an unobserved, latent variable.

In addition to the principal model, and in order to control the robustness of the Tobit's results and the existence of alternative explanations that may account for the finding, we will run an additional analysis including a complementary model that would be the second best option to test our hypothesis.

For choosing the second best model, we must revise the nature of our dependent variable. We can observe that the percentage of ownership abroad is a count variable that is truncated from below at zero. So, there are two models appropriated for analyses of count data in which observations of zero are excluded, **zero-truncated Poisson** and **zero-truncated negative binomial regression**. Zero-truncated Poisson processes assume that the event of interest occurs at a fixed rate over the observation period. These kinds of models are quite restrictive, and need the mean and variance to be equal. However, the variance may be greater than the mean if observations within a year are not independent. Solving this problem, zero-truncated negative binomial regression is an extension of the Poisson model which allows the rate of the underlying processes to vary across observations according to a gamma distribution. So, in order to guide our model choice, we must run a χ^2 test to identify overdispersion (the first one assumes that there is no overdispersion; while the second one corrects this problem).

The Tobit regression results for the international ownership, as well as the results for the complementary model and the criterion for its selection, are displayed in [Table 5](#).

7. I thank an anonymous reviewer for suggestions on this matter.

Table 5. Results of Tobit model and Zero-truncated negative binomial regression of the effects of cultural distance and country risk on the percentage of foreign ownership of subsidiaries by MNE's

	TOBIT				ZERO TRUNCATED NEGATIVE BINOMIAL REGRESSION			
	1	2	3	4	1	2	3	4
Cultural_Dist			8.0587*** (2.3343)	6.5875** (2.3633)			0.0962* (0.0422)	0.0904* (0.0436)
Cultural_Dist & Country_Risk			-24.0405*** (3.5031)	-18.1303*** (4.0738)			-0.3197*** (0.0636)	-0.2876*** (0.0758)
Country_risk		-1.3215 (0.7114)		0.7843 (0.8138)		-0.0186 (0.0124)		0.0165 (0.0152)
Ln Subsidiary_ Size		-0.9274* (0.4054)		-2.3604*** (0.4416)		-0.0144* (0.0071)		-0.0358*** (0.0081)
International_ Strategy		-10.7488*** (1.7346)		-10.3496*** (2.6510)		-0.2214*** (0.0325)		-0.2090*** (0.0499)
International_ Experience		22.4976*** (1.1585)		20.1847*** (1.1843)		0.3501*** (0.0227)		0.3159*** (0.0235)
Ln Size	6.9275*** (0.8175)			5.7128*** (0.7997)	0.0971*** (0.0153)			0.0781*** (0.0154)
Age	0.0286 (0.0367)			0.0349 (0.0328)	0.0004 (0.0007)			0.0005 (0.0006)
Sector_1	0.5792 (12.2372)			-12.0742 (10.0802)	-0.0125 (0.2206)			-0.1575 (0.1856)
Sector_2	1.0733 (11.2586)			-1.1882 (9.2084)	-0.0211 (0.2032)			-0.0245 (0.1690)
Sector_3	-1.7281 (11.9116)			-0.9732 (9.5582)	-0.0031 (0.2151)			-0.0351 (0.1754)
Sector_4	4.7014 (11.5388)			5.1486 (9.6575)	0.0455 (0.2079)			0.0966 (0.1774)
Sector_5	- -			-12.3770 (12.1002)	- -			-0.1586 (0.2229)
Sector_6	11.9920 (12.4487)			2.3858 (10.5333)	0.1448 (0.2239)			0.0076 (0.1936)
Sector_7	17.5669 (11.4868)			13.5669 (9.5645)	0.2142 (0.2069)			0.1874 (0.1754)
Sector_8	-10.2623 (11.6594)			-11.8924 (9.9672)	-0.1546 (0.2101)			-0.2041 (0.1836)
Sector_9	6.9613 (11.20)			-0.2750 (9.1879)	0.0954 (0.2019)			-0.0109 (0.1684)
Sector_10	8.8994 (11.4119)			-4.4624 (9.6605)	0.1160 (0.2056)			-0.0621 (0.1774)
Sector_11	4.1456 (11.2926)			-2.2010 (9.2453)	0.0533 (0.2037)			-0.0224 (0.1698)
Sector_12	-7.8041 (11.4792)			-8.8438 (9.5961)	-0.1214 (0.2069)			-0.1539 (0.1767)
Sector_13	-2.2240 (11.2432)			-10.9045 (9.4423)	-0.0345 (0.2026)			-0.1626 (0.1735)
Sector_14	5.5765 (11.1642)			-3.6247 (9.2857)	0.0614 (0.2011)			-0.0400 (0.1704)

Sector_15	-25.8070* (12.5968)			-24.1517* (11.4794)	-0.4313 (0.2279)			-0.4413* (0.2125)
Sector_16	4.8581 (11.4211)			-9.8225 (9.4855)	0.0558 (0.2057)			-0.1152 (0.1739)
Sector_17	-15.8438 (11.5730)			-13.9330 (9.7672)	-0.2468 (0.2089)			-0.1828 (0.1797)
Sector_18	-14.7307 (12.2904)			-	-0.2073 (0.2217)			-
Sector_19	-2.4891 (11.8024)			-5.1780 (9.7566)	-0.0642 (0.2128)			-0.0947 (0.1792)
Sector_20	15.6414 (12.0725)			10.9673 (9.7985)	0.1994 (0.2178)			0.1203 (0.1800)
Year_2000	-5.0807 (2.9058)			-1.5050 (2.4710)	-0.0465 (0.0525)			-0.0166 (0.0456)
Year_2001	-5.2276 (2.8809)			-	-0.0589 (0.0520)			-
Year_2002	-2.2230 (2.8892)			0.7314 (2.6063)	-0.0332 (0.0519)			0.0155 (0.0481)
Year_2003	-2.0209 (3.0041)			-1.0897 (2.6688)	-0.0299 (0.0540)			-0.0183 (0.0493)
Year_2004	0.6755 (3.0091)			-	0.0046 (0.0541)			-
Year_2005	-			0.0908 (2.722)	-			0.0025 (0.0503)
_cons	36.9828*** (11.9326)	60.0687*** (2.6044)	79.8000*** (0.9261)	32.4342*** (10.1773)	3.7872*** (0.2152)	4.0751*** (0.0464)	4.3795*** (0.0168)	3.6925*** (0.1895)
/sigma lnalpha	28.7386 (0.5884)	23.0843 (0.5464)	29.0659 (0.5747)	21.5264 (0.5264)	-1.3729 (0.0444)	-1.8590 (0.0546)	-1.3298 (0.0427)	-1.9324 (0.0575)
/alpha					0.2534 (0.0113)	0.1558 (0.0085)	0.2645 (0.0113)	0.1448 (0.0083)

Log Likelihood	-5742.37	-4065.81	-6124.49	-3752.15	-6056.41	-4362.23	-6493.66	-4061.00
Wald	154.63***	328.51***	46.48***	437***	88.35***	212.4800***	24.4400***	271.06***
Lhd ratio test of alpha=0					1.10E+04***	5147.2100***	1.30E+04***	4157.61***

* p<0.05; ** p<0.001; *** p<0.0001
Standard deviation in parentheses ()

b) Appropriateness of the Models

Previous to the hypothesis testing, we may discuss how appropriate the statistical techniques are.

- **Principal Model:** Tobit model

Revising the Log likelihood χ^2 test of the four models proposed in this paper, we obtain a p-value <0.0001 in all of them, that leads us to conclude that, at least, one of the regression coefficients in the model is not equal to zero. So, the specified model is statistically correct and we can assume the validity of its results in order to contrast our study.

- **Complementary model:** Zero-truncated Poisson *versus* Zero-truncated negative binomial regression

On the one hand, we have run the LR test of alpha in the four alternative models. Here, the likelihood ratio tests the dispersion of the parameter alpha when it is equal to zero. The meaning of its associated p-value <0.0001 (in every model) implies that the dependent variable is overdispersed and not sufficiently described by the simpler zero-truncated Poisson distribution. As a result, the zero-truncated negative binomial regression is highly recommended.

On the other hand, Log likelihood χ^2 obtains again a p-value <0.0001. So, as same as before, the specified model is statistically correct. Therefore, we can use its results for supporting the robustness of our study.

c) Hypothesis testing using Tobit models

The first column relates to **Model 1**, which contains only four variables related to the domestic parent firm characteristics. The first is the natural log of firm size, the coefficient of which is positive and confirming the expectation that larger firms, with more resources, are more likely to take a larger participation in their foreign subsidiaries. The second one is *Age*, that is a proxy for the overall domestic experience of the company, but it shows no significance here. Finally, we have the categorical variables *Sector* (which has 20 categories) and *Year* (which has 6 categories). The coefficient for *Sector* is only representative for *Sector15*, which is referred to office products and data processing. And, regarding to *Year*, we find that no year is associated with the decision of foreign ownership.

The effects of international characteristics are explored in **Model 2** through the introduction of four variables. We can observe that three of the four explanatory variables are statistically significant. The first is *LnSubsidiary_Size*, the coefficient is negative and statistically significant (p value < 0.05), that means that the larger the oversea subsidiary is, the lower the commitment that parent firm assumes. The second is *International_Strategy*, which behaves in the expected way because it is plenty significant (p value < 0.0001) and shows how companies that pursue international scale economies prefer higher level commitments than the ones that try to adapt their production abroad. The third is *International_Experience*, whose coefficient is positive and strongly significant (p value < 0.0001). This fact implies that the higher the experience in international markets the company has, the larger will be the commitment abroad. The variable *Country_Risk* is not significant, so its effect on the dependent variable cannot be proved.

In **Model 3**, we test for the impact of the independent variables that we are trying to contrast. They have been introduced alone to check the consistency of the results when we run the complete model with the whole set of independent and control variables. Both of them are statistically significant and their coefficients behave as they do in our hypotheses.

In **Model 4**, we present the complete model of analysis. This model shows the strength of the model because; absolutely every variable behaves in the same way as before. The sign and the significant results are consistent among all the models. For that reason, we can study the information provided by *Cultural_Dist* and *Cultural_Dist&Country_Risk*. Our two first hypotheses are trying to understand how companies act upon the commitment they are going to have, depending on the cultural distance they are facing. In this sense, we can assume that the *Cultural_Dist* positive coefficient and p value < 0.001 confirms Hypothesis 2; while Hypothesis 1 has no support. That is, while holding the other variable constant in the model, a large cultural distance compared to a small one (*Cultural_Dist*) is expected to increase the difference in logs of expected counts 6.5875 units, assuming a higher level of commitment in its overseas subsidiary (as it is proposed in Hypothesis H.2).

Notwithstanding, the previous behavior changes when *Cultural_Dist* interacts with country risk (*Cultural_Dist&Country_Risk*). So, when companies decide to locate its assets in a country whose cultural distance is large and, at the same time, its country risk is high (compared to a situation where one of the former variables is “small/low”) the difference in the logs of expected counts would decrease by -18.1303 units, implying a lower rate of ownership in companies located abroad, given the other independent variables in the model are held

constant. In that way, hypothesis H.3 has also found strong empirical support.

The findings indicate that the degree of foreign ownership increases when cultural distance is large, and decrease when the host country is characterized with a large cultural distance and, at the same time, its country risk is high. So, the signs and the significance of the variables representing these factors behave as prescribed in the Hypothesis H.2 and H.3.

In regard to the effect of the control variables, they strongly support their expected behaviors (p value < 0.0001), where Spanish firms prefer higher degree of control abroad when their size is large, their international strategy is global, they accumulate a high degree of international experience and the foreign subsidiary size it is not big enough to mean a real risk for the stability of the company. Regarding to the control variable *Sector*, we must highlight the fact that the category *Sector15* (referred to “Office products and data processing”) is significant in all the models (with a p value < 0.5) and it presents a negative relationship with the dependent variable. That suggests that the group of companies included in this sector tends to have low commitments abroad.

Summing up, the empirical test about the implication that Spanish manufacturing firms have abroad has found sufficient evidences to support the explaining strength of cultural distance and its changing behavior when interacts with country risk.

d) Robustness of the results

We evaluated the robustness of our results in several ways. First, we have run the models using two different statistical methods. On the one hand, we have used a Tobit regression; and, on the other hand, we have repeated the regressions using a zero-truncated negative binomial one. The

results displayed on [Table 5](#) show the identical behavior of the full set of variables. All of them present the same significance and the coefficients show the same sign. Even the case of the control variable *Sector15* is relevant with the new statistical technique.

Second, both contrasting techniques have been split in four models, each of them including a different group of variables to evaluate the sensitiveness of the variables. Revising the eight models, we can conclude that all of them maintain the same sign and significance.

These results confirm that the explanatory power of the independent variables is insensitive to the inclusion of control variables, as well as the statistical method used on data, because all the approximations yield identical behaviors for the present analysis, indicating an appealing robustness for the results.

In summary, our robustness checks provide further evidence to support our conceptual framework in this study.

4. Conclusions

The main purpose of this research is to analyze carefully how important the cultural distance is, and how companies must adequate their ownership levels over subsidiaries according to cultural and country risk specifications. In order to do so, we have used some real cases of Spanish companies and, for a deeper knowledge, we developed a statistical analysis over a representative sample of Spanish manufacturing firms over 2000-2005. Taking altogether, we are able to assume some implications that managers may want to take into consideration before going abroad.

This research has contrasted the relevance and great impact that cultural distance has on business decisions. In that way, managers should study cautiously the specific characteristics of every country, even when there are no signals of differences apparently. Nevertheless, analyzing cultural distance is necessary but not enough. So, cultural distance and country risk should be considered both together before taking the final decision about the ownership level.

When the time comes to enter a foreign country, the company should consider country's social, legal, economic and political framework. It is in this context where we find target country risk (Quer *et al.*, 2007). Country risk strengthens the uncertainty perceived from demand, competitors, costs and other market conditions. In that way, managers should try to extrapolate their results to these much riskier environments and should think over more flexible alternatives in case of leaving the country to reduce substantial losses.

Therefore, we assume that managers generally prefer higher commitment levels when going abroad and, cultural distance does not change this first choice because, taking the rest of the environment favorable, they are able to handle it by themselves or by the purchase of a lo-

cal company which owns all the knowledge they need to adapt successfully to the new circumstances. As a side note, we can observe how large cultural distances increase risk perception but only from the point of view of lack of knowledge for adaptation and implementation of the home routines and strategies inside the local market. For that reason, this kind of problems can be solve by the acquisition of a local company. However, country risk works in a different way because it is an exogenous variable which cannot be avoided by the full commitment. Indeed, the highest level of ownership will be the worst possible option for two reasons: (a) if the new international business fails because of external causes, a normal decision will be to abandon such country and turn back home; in that situation, if the level acquired was 100% the exit cost will be a high exit barrier, and the company will suffer serious loses; and (b) countries characterized by a high country risk usually are much riskier for foreign companies, because they will be the first ones to suffer expropriations and hostile movements; that is why companies must reduce this risk by the collaboration with a local partner, who will be the local image of the company in order to not be perceived as an intruder. Summing up, cultural distance means a higher perceived risk, but this one can be manage successfully by full ownership. Notwithstanding, large cultural distance and high country risk increase too much the perceive risk and, the highest level of ownership is not a recommended option; the best option in that situations is lower commitment levels and, if possible, with the collaboration of a local partner.

In addition to the consideration of cultural distance and country risk, companies should confer importance on the following factors: parent company size, subsidiary size, international strategy and international experience.

All the factors mentioned above were statistically significant, for that reason they involve an important impact on the company when going abroad.

An enormous part of the empirical research has observed that parent company size is related with the level of ownership assumed. This is a phenomenon worthy of consideration because many medium-size and small businesses are increasingly involved in international markets, although most international investments are conducted by large firms, so managers need to know how they perform.

In keeping this, larger companies have more resources to absorb the high cost of producing and marketing in a foreign country than smaller firms. They can afford to acquire local firms with all the needed know-how inside, or setting up a Greenfield hiring the best experienced specialists. Therefore, high ownership levels are likely and, if cultural distance is large, are also recommended to avoid opportunistic behaviors and control problems. Nevertheless, most small and medium-sized MNEs rarely have the needed assets to compensate for the inherent disadvantages of being a foreign company (Beamish and Lee, 2003), for that reason they probably do not have another chance than lowering ownership commitment through the collaboration with a local partner.

Subsidiaries are playing an increasing role in generating competitive advantage for the overall MNE. For that reason, some of their characteristics will be relevant for the ownership level decision. That is to say, subsidiary size will entail an important place, and managers may want to select commitment levels in order to reduce the risk associated with the investment assumed and lower the negative impact of this risk. In that way, the larger size of the subsidiary, the riskier the investment. So, when com-

panies pursue a large foreign project which needs an important amount of money (for its developing and implementation, including all the staff and workers) it could be a good idea to set up the large subsidiary in collaborations with other companies, in order to minimize the investment risk abroad. In our sample we can observe how companies whose foreign subsidiary has a big size, they tend to diminish the ownership level.

It is worthy of note how managers may need to select a commitment level capable of developing a successful integration of the international strategy with the environment. In this vein we find the paper of Almodóvar and Navas (2009) who state that multidomestic strategies will demand lower ownership levels through the establishment of international joint ventures with local partners to compensate the lack of knowledge derived from market heterogeneity; and global strategies will be related with whole ownership subsidiaries in order to have the full control and to achieve economies of scale from coordinating production across countries. These results concur with our empirical analysis where the relationship between multidomestic strategies and high ownership levels is negative.

Another variable, that statistically has been significant, is international experience that has been defined by Slangen and Hennart (2008) as company experience with managing operations outside its home country, without reference to specific host countries. They explain how these experiences may reduce the additional management costs of full ownership in culturally distant countries, because they act as mechanisms that lower cultural challenges. So, the gain of international experience may enable a MNE to heighten its level of commitment abroad.

Summarizing, our results may become useful for managers assessing international involvement because, as we have shown, they would have to select the optimum ownership level under a given set of cultural distance and country risk circumstances. They are powerful determinants of company success and they should be well known to handle them in the best way.

Acknowledgements

The author would like to thank Complutense University of Madrid for financially supporting this research under its Grant Mobility Program 2008; and the Education Ministry of Spain for the same reason under its Grant "Jose Catillejo 2008". I am grateful for valuable discussions with Brian Silverman and Pedro Nueno, and all the information provided by the mentioned companies. Part of this paper was written while visiting Rotman School of Management and CEIBS as a visiting fellow. All remaining errors are mine.

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