

# Distance factors and establishment mode choice of emerging-market multinationals: The moderating effect of administrative distance

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## Abstract

Regulations, governance quality, and political structure are important factors that may alter the cost and difficulties associated with doing business in foreign markets. Emerging-market multinationals (EMNEs), with an imperative motivation to go abroad and to be competitive in a global landscape, should consider the impact of administrative distance, namely, the regulatory institutional differences between home and host countries. We suggest that the study of administrative distance is particularly important when addressing investment flows from emerging economies to developed ones, because of the differences between them. Drawing on transaction cost theory and institutional perspective, we analyze the moderating effect of administrative distance on the relationship between other cross-national distance factors—cultural, geographic and economic—and establishment mode choice of EMNEs. From a sample of 357 outward foreign direct investments carried out by Indian firms, our results show that administrative distance moderates the relationship between cultural, geographic and economic distance, and establishment mode decisions.

## KEYWORDS

Acquisitions, administrative distance, EMNEs, greenfield investments

## INTRODUCTION

In recent decades, studies focusing on emerging-market multinationals (EMNEs) have increased in a wide variety of topics. The international business (IB) literature has addressed, for instance, the internationalization paths followed by EMNEs, whether they internationalize to gain new competitive advantages or to exploit existing ones, and whether new theoretical explanations are needed to more comprehensively explain their international decisions (Guillen & Garcia-Canal, 2009; Gammeltoft et al., 2010; Cuervo-Cazurra, 2012; Hennart, 2012; Narula, 2012; Ramamurti, 2012).

Entry mode choice is a key decision when doing business abroad, since it may be irreversible and multiple

factors exert an influence on it. It is possible to distinguish between two specific categories of foreign market entry modes: ownership modes—wholly-owned subsidiaries and joint ventures—and establishment modes—greenfield investments and acquisitions (Barkema & Vermeulen, 1998). The latter refers to the choice between the creation of a new subsidiary from scratch (greenfield investment) and the takeover of an existing company (acquisition). How EMNEs make this choice deserves further research attention because their behavior may differ from that of multinational enterprises (MNEs) from developed countries. Studies focused on establishment modes and EMNEs could identify new empirical patterns, or new theoretical explanations (Alon et al., 2011; Buckley et al., 2007). Testing existing theories in countries at different levels of development is needed (Hennart & Slangen, 2015) because the high-risk

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environment that is usually characteristic of their home markets may lead EMNEs to follow a distinctive decision-making process (Chikhouni et al., 2017; Alon et al., 2020).

The research in the establishment mode decision under uncertainty is scant and is mostly focused on Western companies. Moreover, political or regulatory institutional uncertainty is one of the main determinants of the establishment mode choice in the case of firms from developed markets (Brouthers & Dikova, 2010; Slangen, 2013) and emerging markets (Sun et al., 2021). This political uncertainty is reflected in one of the distances proposed by Ghemawat (2001), the administrative distance. This author argues that distance matters when making decisions in an international context. A large administrative distance is especially challenging for EMNEs that are expanding from less-developed markets with weak institutional environments to developed markets with efficient institutional environments and less government intervention (Wu et al., 2021). Such institutional differences pose greater challenges for EMNEs due to their latecomer status.

Differences in administrative distance may even influence other factors previously studied, such as the role of cultural, geographic and economic distance, on which we find recent literature linking establishment mode decisions and EMNEs (Rienda et al., 2019a; Tokas & Deb, 2020; Wu et al., 2021). The conventional effect of different distance factors in such decisions is negative, that is, entering close countries or with less distance reduces the uncertainty associated with the internationalization process (Johanson & Vahlne, 1977). Nevertheless, the effects of these specific factors could differ when the MNE's home country is an emerging market. In terms of distance, markets where political uncertainty is greater from the home country are associated with greater uncertainty and a low institutional quality. However, if the starting point is an emerging market, with greater institutional uncertainty, increasing the distance and investing in developed markets makes the environment friendlier and even reduces the impact of other distances. This is why administrative distance could reduce the effect of other distances.

This study provides new insights into the influence of cross-national differences on EMNEs' establishment mode choice, using both transaction cost economics (TCE) and institutional theory (IT). Both theoretical frameworks are concerned with environmental uncertainty (Chen et al., 2009). TCE analyses opportunism problems, limited rationality, and transaction costs (Anderson & Gatignon, 1986; Buckley & Casson, 1976). Firms select the entry modes which have the lowest transaction costs (Buckley & Casson, 1976; Dunning, 1988). Traditionally, EMNs select greenfield investments in distance markets because it is considered a more efficient mode of entry due to their lower transaction costs (Brouthers & Brouthers, 2000). Nevertheless, this

study considers the need to combine the perspective of TCE with insights from IT, including the central role of host country institutional framework in enabling or constraining MNEs' behavior (Dikova & van Witteloostuijn, 2007), very interesting when we focus on EMNEs. The effectiveness of a country's national institutional framework affects the functioning of the market economy as well as the strategies and operations of firms (Kostova & Marano, 2019). For EMNEs, institutional differences are highly significant (Globerman & Shapiro, 2003) and not only contributes more to uncertainty and cost, but also provides an opportunity not applicable to other types of distance: that is, institutional arbitrage as EMNEs as rapidly expanding into foreign markets due to a variety of motives such as escaping from poor institutional environments, as well as acquiring strategic assets. This argument brings new insights about the traditional theories of internationalization when dealing with EMNEs.

More precisely, following the ideas of IT, the study of administrative distance between countries is especially important when addressing investment flows from emerging to developed markets, because of the differences between both types of economies (Aleksynska & Havrylchuk, 2013). The uncertainty level is usually higher for investment flows from developed to emerging markets. However, what happens with reverse investments? Could administrative distance be a key factor for EMNEs? Does administrative distance moderate the influence of other distance factors? The relationship between distance factors, host country's regulatory institutional characteristics, and establishment mode choice is rarely studied for EMNEs, in particular, when they enter developed countries. Therefore, the aim of our study is to highlight the importance of administrative distance analyzing its moderating influence on the other distance factors when making decisions on establishment mode.

Analyzing a sample of 357 outward foreign direct investments (OFDIs) of Indian MNEs, we find that administrative distance moderates the relationship between cultural, geographical and economic distance factors. The key contribution of our paper, based on the results obtained, is to provide a more comprehensive understanding of the effect of distance factors on EMNEs' establishment mode choice, considering administrative distance as a critical factor. The paper comprises a simultaneous analysis of home-host country distance, host country's regulatory institutional framework, and establishment mode choice by Indian MNEs.

The literature review and hypotheses development are presented in the next section. We continue with a description of the methodology used. A brief summary of the findings is then presented together with the discussion. Finally, we present the main contributions and limitations of our study, as well as potential avenues for future research on this topic.

## THEORY AND HYPOTHESES

### CAGE framework and the role of administrative distance for EMNEs and establishment mode choice

Ghemawat (2001) argued that distance matters when making decisions in an international context, proposing the CAGE framework that considers four types of distance: cultural, administrative, geographic, and economic. The influence of individual distance factors on entry mode choice has been widely analyzed in the IB literature (Arslan & Larimo, 2011; Slangen & van Tulder, 2009). However, studies that integrate various distance factors into a single model are less common (Berry et al., 2010). In addition, prior research addressing the simultaneous influence of the four distance factors suggested by the CAGE framework on establishment mode choice is scarce (Rienda et al., 2019a).

From a traditional perspective, where studies and decisions made by Western companies predominate, cultural, administrative, geographic, and economic distance between countries may increase the uncertainty of doing business in target markets and have an impact on establishment mode choice. Nevertheless, when we focus our attention to MNEs from emerging markets, decisions about establishment mode choice are significantly affected by administrative distance, where the host country institutional environment plays a crucial and different role (Korsakiene et al., 2015; Wu et al., 2021).

As IT proposes, regulatory and governance institutions play a critical role in MNE's behavior (Xu & Shenkar, 2002). Some government actions can promote a positive environment for foreign investments, while many regulations create an environment that discourages MNEs from entering a foreign market (Holmes et al., 2013). As a result, MNEs' managers usually value institutional environments that promote free and open markets (Globerman & Shapiro, 2003). Investments in countries with weak regulatory and unstable governance systems are perceived as too risky. Hence, doing business in those countries increases the level of uncertainty for foreign firms. Conversely, a high institutional quality level may reduce the costs and risks of doing business in a foreign country (Hutzschenreuter et al., 2014). Regulatory institutional differences between countries have an influence on the costs of doing business abroad in several ways. They may affect not only interaction and communication between foreign firms and host governments, but also the relationships with customers and other firms (Dow & Karunaratna, 2006). Accordingly, administrative distance may promote some behavioral patterns but also discourage others, influencing the choice between several strategic options by foreign firms (Arslan & Larimo, 2011; Xu & Shenkar, 2002).

As for establishment mode, the lack of transparency and information of potential target firms, which appear

in weak institutions, increase the uncertainty and may reduce the likelihood of choosing acquisitions as compared to entering host countries with high institutional quality (Lin et al., 2009). From an EMNE, entering a host country with which there is a greater administrative distance usually means entering a developed country with higher institutional quality and this may alleviate uncertainty. Therefore, when host country's institutional quality is low, foreign firms may prefer a greenfield investment instead of an acquisition (Morschett et al., 2010). This will be the case of EMNEs entering other emerging markets, namely, where there is a lower administrative distance.

### The moderating effect of administrative distance on establishment mode choice by EMNEs

Cultural distance is one of the most important factors influencing decision-making in international markets. It is related with country differences in terms of culture, economic systems, and business practices (Hofstede, 1989; Kogut & Singh, 1988). When cultural distance between countries is high, the perceived uncertainty increases (Anderson & Gatignon, 1986). Prior research emphasizes a negative relationship between cultural distance and the use of acquisitions (Arslan & Larimo, 2011). This is due to the problems to implement an acquisition (Weber et al., 1996) and the cost and time to resolve conflicts (Malhotra et al., 2009). In addition, there is a cost of interpreting information flows and the risk of misunderstanding such information. Thus, the option to establish in the foreign market through greenfield subsidiaries should be more successful (Barkema & Vermeulen, 1998).

As for EMNEs, most past studies found a negative relationship between cultural distance and acquisitions, thus suggesting that EMNEs prefer acquisitions in host countries that are culturally closer (Buckley & Munjal, 2017; Malhotra et al., 2009; Rienda et al., 2019a). Nevertheless, other studies found the option of acquisition as a priority for EMNEs, if the objective is seeking strategic assets, although the investment is made in culturally distant countries (Mathews, 2002). These inconclusive results could be explained from an institutional perspective. Some scholars observed negative societal attitudes underpinned by a distinct institutional legacy, hindering entrepreneurial rates and initiatives (Manolova et al., 2008). The normative pressures lead the organizations to be guided by legitimated elements and adoption of these elements increases the probability of survivor (Korsakiene et al., 2015). Despite the negative influence that cultural distance could have on the choice of acquisitions as establishment mode choice, favorable institutional regulation and the search for greater legitimacy in the host country make this choice the best option for EMNEs when they set up in developed host

markets and, therefore, the administrative distance is greater. The cultural problems that arise with an acquisition should be reduced because the firm gain legitimacy for the society. Therefore, the influence of cultural distance could be different depends on the institutional environment of host country. Hence, we propose our first hypothesis:

**Hypothesis 1.** A high administrative distance positively moderates the impact of cultural distance on the probability of choosing acquisitions by EMNEs.

Similarly to cultural distance, Slangen (2011) proposes that verbal communication barriers associated with geographic distance will also make entry firm tend to choose greenfield investments because acquisition needs much more communication among firms compared to greenfield. His study confirmed that the costs of communication between subsidiaries and MNE's headquarters increase with geographic distance and acquisitions. Also, the knowledge flows in the case of acquisitions is usually difficult because the employees of acquired subsidiaries are less receptive to it (Gupta & Govindarajan, 2000). It could be very difficult for an MNE to integrate the organizational practices and work force representing very different professional and corporate cultures into the acquired subsidiary. In such cases, greenfield investment appears as an attractive establishment mode option for investing MNEs (Arslan & Larimo, 2011). With a greater geographic distance, the transaction costs associated with exploiting the knowledge through greenfield are generally lower than those associated with exploiting them through acquisitions (Dadzie & Owusu, 2015).

For EMNEs, prior studies found that the geographic distance makes more difficult the acquisition of a target firm (Malhotra et al., 2009). However, some studies reported a non-significant relationship between geographic distance and establishment mode choice by EMNEs (Buckley et al., 2017; Buckley & Munjal, 2017; Rienda et al., 2013). Again, the disparity of results may be motivated by the evidence that the host country matters, and decisions about establishment mode choice in geographical distant countries may also depend on the institutional characteristics of the host country (Rienda et al., 2019b). For EMNEs, a high administrative distance between the home and the host country may be associated with a lower risk in the latter. Therefore, the negative effect of geographic distance could be reduced if the investments are made in countries with a high administrative distance, usually with a high-quality institutional environment to do business and opting for acquisitions in this case. The costs of communication and the differences on organizational practices should be alleviated in friendly institutional environments, with less legal uncertainties, obstruction of domestic acquisitions

or regional protectionism (Wu et al., 2021). The next hypothesis arises with these arguments:

**Hypothesis 2.** A high administrative distance positively moderates the impact of geographic distance on the probability of choosing acquisitions by EMNEs.

Finally, some prior studies highlight that economic distance difficult foreign market entry (Ghemawat, 2001; Malhotra et al., 2009). For EMNEs, greenfield subsidiaries allow us to replicate the same business model, and it would be easier when they enter other emerging economies. Conversely, if EMNEs invest in foreign countries that are more developed than their home countries—therefore, with a higher economic distance—an acquisition may be more desirable. Actually, prior research reported that, when entering developed countries, EMNEs prefer cross-border acquisitions, usually because they are looking for valuable strategic resources (Buckley & Munjal, 2017). As a result, we may expect a negative relationship between a higher economic distance and the option of greenfield investments (Tsang & Yip, 2007). However, other studies failed to obtain a significant influence of economic distance on establishment mode choice by EMNEs (Rienda et al., 2019a). The influence of economic distance on establishment mode choice also could be different attending to administrative distance. EMNEs may have accumulated at home the required expertise and managerial capabilities to do business in other emerging markets also characterized by poor institutions (Buckley et al., 2007). Wright et al. (2005) propose that firms moving from emerging markets to other emerging destinations are more likely to emphasize exploitation instead of exploration because their resources and capabilities may be more easily transferable to an institutional setting similar to that of their home country (Luo & Peng, 1999). Therefore, we propose that:

**Hypothesis 3.** A high administrative distance positively moderates the impact of economic distance on the probability of choosing acquisitions by EMNEs.

## METHODOLOGY

### Sample

This research is focused on EMNEs and the investments made by these firms. EMNEs expand in a different pattern in foreign markets as they do not take into account unique challenges and opportunities for EMNEs facing large administrative or regulative distance (Wu et al., 2021). The study sample includes large Indian MNEs excluding small- and medium-sized firms whose

internationalization strategies might be more restrictive by the lack of financial and human resources, and could distort our analysis of establishment modes (Boellis et al., 2016). Several reasons explain why we have chosen India as a home country. First, India has been characterized by its great potential, being the second emerging economic power after China. The opening up of its economy started in 1991 through a series of measures promoting liberalization. Second, there has been a rapid expansion of India's outward foreign direct investment (OFDI) since the 1990s. As a result, a large number of Indian firms are aggressively carrying out cross-border acquisitions in order to access foreign markets or to acquire existing world-class brands (Buckley et al., 2016; Buckley & Munjal, 2017; Hoskisson et al., 2013; Rienda et al., 2011).

The data was collected as follows: first, the Indian MNEs that were in the Forbes 2000 ranking—2015 edition—were selected (47 of 54 Indian companies were MNEs). The selected companies are in line with the aim of the work, which focuses on higher commitment establishment modes. Acquisitions and greenfield investments can be seen as alternative investment strategies with differing levels of local resource deployment, adaptation and market-specific transaction costs (Alon et al., 2020). The experience and the resources they accumulate make it possible to reduce uncertainty (Pan & Tse, 2000) and opt to a lesser extent for shared hierarchical modes such as joint ventures; second, we examined the foreign entries carried out by each MNE. With a view to reduce the possible “missing” decision about establishment abroad, an exhaustive revision of news and events by the corporate website of each firm and by different secondary sources (*Centre for Monitoring Indian Economy*, *Financial Times*, and *Business Standard*) were analyzed from 2000 to June 2020. Social research dealing with measurable data will have to use a quantitative research method applied either on pre-existing data provided by various sources (secondary data) or on data produced ad hoc by the researcher him/herself (primary data). Then, we based our study on secondary data, due to the difficulties to find complete data and information about cross-border acquisitions by Indian MNEs, similarly to other studies in this area (Bono et al., 2012; Neubert, 2018; Rienda et al., 2013). After completing this process, the final sample was 357 OFDIs in 75 countries (163 acquisitions and 194 greenfield investments).

## Dependent variable

The *establishment mode* of each OFDI decision is our dependent variable. We considering only higher commitment, but not shared, investments. Then, we measured it with a dummy variable: with a value of 1 for acquisitions, and a value of 0 for greenfield investments (Lee & Lieberman, 2010; Rienda et al., 2013).

## Independent variables

We consider the four types of distance as independent variables. First, attending to *cultural distance* (CD), a composite index is required when the nature of the theoretical arguments has to do with distance in general (Beugelsdijk et al., 2018). We have used the Kogut and Singh's index (1988), based on Hofstede's six dimensions, between India and each host country. Countries with values close to 0 in this variable are culturally similar to India, while high values mean a greater cultural gap. This index has been used to measure cultural distance in related studies (Aybar & Ficici, 2009; Barkema & Vermeulen, 1998). The variable was log-transformed to correct for skewness.

Second, for *administrative distance* (AD) we created an index of administrative quality for India using the Worldwide Governance Indicators (WGI) project of the World Bank, and an index for each host country, and then use the ratio of the host-country's index over India's index. With it we considered the “relative” administrative quality. We log-transformed this new variable. Moreover, following the same steps of Powell & Rhee (2016), if some of the host countries actually have lower levels of administrative quality, this measure can be further split into a spline function to indicate separate slopes for *high-quality institutional* environments (AD1) or *low-quality institutional* environments (AD2) in the host country relative to India. We expect a positive relationship between distance and establishment modes from more transparent nations.

Third, the Geobytes database was used to proxy *geographic distance* (GD). This database calculated the distance in kilometers between the capital cities of India and each host country (Malhotra et al., 2009; Ojala & Tyrväinen, 2007). With the aim to normalize the distribution of this variable we used a logarithmic transformation.

Finally, *economic distance* (ED) was operationalized using gross domestic product (GDP) per capita. We considered the absolute difference in GDP per capita between India and each host country in the year prior to entry. The information was collected from The World Bank. Previous studies used this measure to assess economic development of a country as well as economic distance between countries (Dow & Karunaratna, 2006; Malhotra et al., 2009; Tsang & Yip, 2007). A logarithmic transformation was carried out (Malhotra et al., 2011).

## Control variables

### Firm-level variables

*Firm size* is a critical factor in IB research and past studies considered the effect of this factor on decisions about internationalization of Indian firms (Kumar, 2007).

Thus, we controlled the influence of firm size through the variable number of firm employees, with a logarithmic transformation.

Similarly, establishment mode decisions are also affected by firm international experience (Rienda et al., 2018). We used three variables to control for firm international experience (Barkema & Vermeulen, 1998; Kogut & Singh, 1988). First, the number of previous acquisitions in host countries was used to measure *Host country acquisition experience*. Second, the number of previous greenfield investment in each foreign market was used to measure *Host country greenfield experience*. Third, the number of previous OFDIs before the focal entry was used to measure *General international experience*.

### Country-level variables

Attending to country-level variables, first, when home and host countries share a common official language, the barriers to enter in a particular host country using acquisitions may be reduced (Buckley et al., 2012). We controlled for this country-level variable, which may affect communication, thus facilitating or hindering bilateral investments and knowledge exchange between countries (Castellani et al., 2013). Following Dow & Karunaratna (2006), we considered the differences in language including a dummy variable named *English language* that takes the value of 1 when both India and the host country use English language as official language, and 0 otherwise.

Second, following Berry (2006) and Powell & Lim (2017) there will be differences in the technical knowledge of the nations, considering some nations as “laggards” and others as “leaders.” Accessing locally embedded technical and process knowledge can be an element of acquisitions motives in the case of EMNEs, often latecomers to their prospective industries, with the aim to improve the global competitiveness (Kedia et al., 2012; Mathews, 2002). Using The World Bank data, we calculated a new variable named *Host knowledge*. It is the sum of the total resident patent applications per million resident and total scientific and technical articles published per million residents for India and each host country during the year before of each investment. For each country, the total patents and articles published were added together, and the sum for each host nation was divided by the sum for India. This measure gave us a measure of host country technical knowledge production relative to India.

Third, the host restrictions on FDI (*FDI restrictions*) is another factor that could potentially influence the investment in foreign markets (Powell & Rhee, 2016). We controlled for it using the data on the Business Impact of Rules on FDI item from the Global Competitiveness Report. We performed a logarithmic transformation to enhance the normality of the distribution.

### Industry-level control variables

Industry characteristics may also affect establishment mode choice (Kogut & Singh, 1988). The relationship between firm’s technological resources and the used of acquisitions was previously studied for Indian MNEs (Buckley et al., 2016). Thus, using the Organization for Economic Co-operation and Development (OECD) classification, we controlled for industry technological intensity (Chen & Hu, 2002; Rienda et al., 2013). In doing so, we created four *Industry* dummy variables based on their technological intensity: low; medium-to-low; medium-to-high; and high.

### Time control variables

Finally, we also controlled for *Time* fixed effects since changes over time may have an impact on firm’s acquisition capabilities. Gradual changes in OFDI policies in India could affect the establishment mode path of Indian MNEs (Buckley et al., 2016). Hence, we included 19-year dummies, being the year 2000 the benchmark.

## RESULTS

A binomial logistic regression was used to test the hypotheses. This statistical method was applied because of the ability of logistic regression techniques to

**TABLE 1** Countries by investments

Country	Acquisitions	Greenfields	Total
US	43	12	55
UK	11	11	22
Australia	17	4	21
China	2	16	18
Singapore	1	12	13
South Africa	6	5	11
Mozambique	7	4	11
Brazil	4	6	10
UAE	0	9	9
Sri Lanka	2	7	9
Hong Kong	0	9	9
Germany	6	3	9
Canada	5	4	9
Italy	6	2	8
Indonesia	4	3	7
Others	49	87	136
Total	163	194	357

*Notes:* In others we have included the rest of countries that have less than seven investments in total. A total of 75 different host countries are included in this study.

TABLE 2 Descriptive statistics and correlations (N = 357)

	Mean	SD	Maximum	minimum	1	2	3	4	5	6	7	8	9	10	11	12	13
1. Establishment mode	0.46	0.49	1	0													
2. Cultural distance	0.11	0.23	0.58	-0.54	0.24**												
3. Administrative distance	-0.02	0.44	0.37	-1.70	0.19**	0.35**											
4. High-quality institutional environments	0.98	0.79	2.34	0	0.16**	0.39**	-										
5. Low-quality institutional environments	0.09	0.22	1.30	0	-0.08	-0.19**	-	-0.53**									
6. Geographic distance	3.80	0.24	4.23	2.90	0.22**	0.60**	0.27**	0.31**	-0.16**								
7. Economic distance	1.09	0.57	1.92	-0.28	0.03	0.38**	0.65**	0.64**	-0.58**	0.22**							
8. Firm size	4.62	0.49	5.55	2.85	-0.15**	0.00	-0.07	0.09	-0.19**	0.11	0.07						
9. Host country acquisition experience	0.46	1.36	10	0	0.27**	0.20**	0.14*	0.17**	-0.12*	0.26**	0.08	0.08					
10. Host country greenfield experience	0.18	0.56	3	0	0.12*	0.14**	0.05	0.15**	-0.14*	0.17**	0.06	0.27**	0.19**				
11. General international experience	7.07	80.84	44	0	0.14*	0.22**	-0.00	0.12*	-0.20**	0.24**	0.04	0.43**	0.39**	0.59**			
12. English language	0.47	0.50	1	0	0.14*	0.15**	0.44**	0.50**	-0.10	0.45**	0.23**	0.02	0.27**	0.10	0.06		
13. Host knowledge	4.21	19.24	205.82	0	-0.05	0.12*	0.09	0.16**	-0.09	0.16**	0.21**	0.10	0.01	-0.00	-0.08	0.15**	
14. FDI restrictions	1.53	0.46	2.13	0	0.14*	0.10	-0.36**	-0.50**	0.23**	0.22**	-0.38**	-0.08	0.04	-0.01	-0.02	-0.27**	0.13*

\*\*p &lt; 0.01; \*p &lt; 0.05.

T A B L E 3 Logistic regression for establishment mode choice

Variables	Model 1 β	Model 2 β	Model 3 β	Model 4 β	Model 5 β	Model 6a β	Model 7a β	Model 8a β	Model 9a β	Model 10a β	Model 11a β
<i>Predictor variables</i>											
Cultural distance (CD)		-1.48*** (0.413)				-1.155* (0.305)	-1.104† (0.332)	-0.243 (0.785)	0.408 (1.504)	-1.223* (0.294)	0.473 (1.605)
Administrative distance (AD)			1.283** (3.609)			1.160* (3.190)					
High-quality institutional environments (AD1)							0.857** (2.355)	-0.117 (0.890)	-12.724** (0.001)	2.082* (8.019)	-8.977† (0.001)
Low-quality institutional environments (AD2)							0.635 (1.886)	1.216 (3.374)	2.069** (7.915)	1.789 (5.986)	3.081* (1.781)
Geographic distance (GD)				1.162** (3.195)		1.257** (3.515)	-0.307 (0.736)	0.804† (2.235)	0.681 (1.975)	-0.512 (0.599)	0.410 (1.507)
Economic distance (ED)					-0.180 (0.836)	-0.497 (0.608)	-0.882* (414)	-0.472 (0.624)	0.396 (1.487)	0.110 (1.116)	1.136 (3.115)
<i>Interactions</i>											
AD1xGD								0.603* (2.235)			0.497* (1.644)
AD1xGD									3.432** (30.944)		2.650* (14.147)
AD1xED										-1.117† (0.0327)	-1.197† (0.302)
<i>Control variables</i>											
Firm size	-0.966** (0.381)	-0.997** (0.369)	-0.379** (0.684)	-1.131*** (0.323)	-0.928** (0.395)	-0.757† (0.471)	-0.897** (0.408)	-0.768* (0.464)	-0.750* (0.472)	-0.824* (0.439)	-0.663† (0.515)
Host country acquisition exp.	0.127** (1.135)	0.143** (1.153)	0.140** (1.150)	0.122** (1.129)	0.060 (1.061)	0.038 (1.039)	0.095 (1.099)	0.088 (1.092)	0.071 (1.074)	0.106† (1.112)	0.087 (1.091)
Host country greenfield exp.	-0.017 (0.984)	-0.032 (0.968)	-0.017 (0.983)	-0.026 (0.974)	-0.065* (0.937)	-0.063† (0.939)	-0.072* (0.931)	-0.098** (0.907)	-0.084* (0.919)	-0.071* (0.932)	-0.095** (0.909)
General international exp.	0.361* (1.435)	0.356* (1.427)	0.271† (1.311)	0.388* (1.473)	0.520* (1.682)	0.421 (1.524)	0.396 (1.486)	0.469† (1.598)	0.445† (1.561)	0.334 (1.396)	0.403 (1.496)
English language	0.676* (1.966)	-0.254 (0.776)	0.831* (2.296)	0.429 (1.535)	0.918** (2.503)	-0.113 (0.893)	0.128 (1.137)	0.004 (1.004)	-0.021 (0.979)	0.254 (1.289)	0.022 (1.022)

(Continues)



TABLE 3 (Continued)

Variables	Model 1	Model 2	Model 3	Model 4	Model 5	Model 6a	Model 7a	Model 8a	Model 9a	Model 10a	Model 11a
	$\beta$	$\beta$	$\beta$	$\beta$	$\beta$	$\beta$	$\beta$	$\beta$	$\beta$	$\beta$	$\beta$
Host knowledge	0.050 (1.051)	0.040 (1.041)	0.043 (1.044)	0.028 (1.028)	0.24 (1.024)	-0.002 (0.998)	0.026 (1.027)	-0.006 (0.995)	-0.093 (0.912)	0.058 (1.059)	-0.039 (0.961)
FDI restrictions	0.003 (1.003)	-0.002 (0.998)	0.015* (1.015)	0.002 (1.002)	0.005 (1.005)	0.009 (1.009)	0.007 (1.007)	0.008 (1.008)	0.004 (1.004)	0.004 (1.004)	0.001 (1.001)
Industry effect	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Year effect	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Chi-square	50.408***	64.537***	55.030***	57.148***	41.629***	57.131***	53.075***	59.778***	62.313	56.656***	68.711***
Cox R <sup>2</sup>	0.164	0.205	0.219	0.184	0.168	0.276	0.208	0.232	0.240	0.221	0.261

Notes:

† p &lt; 0.1,

\* p &lt; 0.05, \*\* p &lt; 0.01, \*\*\* p &lt; 0.001. Standard errors are reported in the parenthesis.

incorporate a wide range of diagnostics, the dichotomous characteristic of the dependent, and the mix of continuous and categorical independent variables we use (Hair et al., 1995). Previously, we examined the variance inflation factor (VIF) values. These values ranged between 1.23 and 4.73 (considering AD in the model), and between 1.22 and 4.30 (considering low and high-quality institutional environments). Consequently, there was no particular concern about multicollinearity issues (Kutner et al., 2004). In Table 1 the investment by country was presented. In Table 2 we can see descriptive statistics and correlations.

Table 3 presents the logistic regression results. Model 1 contains control variables. Models 2–5 include the impact of each individual distance on establishment mode choice for a multicollinearity concern. Model 6a includes direct effects of each type of distance together, and Models 7a–11a reflect the moderating effect of administrative distance. We obtained a significant positive interaction between administrative distance—high-quality institutional environments—and cultural distance (Model 8a,  $b = 0.60$ ,  $p < 0.05$ ). Therefore, we found support for our first hypothesis that consider the positive moderate impact of high administrative distance on the relationship between cultural distance and the probability of choosing acquisitions by EMNEs. Similarly, we obtained a positive interaction with geographic distance (Model 9a,  $b = 3.43$ ,  $p < 0.01$ ). This result confirms that a high administrative distance positively moderates the impact of geographic distance on the probability of choosing acquisitions by EMNEs. Finally, we found a significant but negative interaction with economic distance (Model 10a,  $b = -1.11$ ,  $p < 0.1$ ).

To further examine the latter finding, that was contrary to was expected, we tested a curvilinear relationship introducing the squared economic distance term and calculating all relationships again in Table 4 (Models 8b–11b). The results for cultural and geographic distance are similar to those reported in Table 3 (Model 8b,  $b = 0.55$ ,  $p < 0.01$  and Model 8b, 3.18,  $p < 0.01$ ). For economic distance, the introduction of squared economic distance term changes the sign of the interaction coefficient from negative (Model 10b,  $b = -2.33$ ,  $p < 0.01$ ) to positive (Model 10b,  $b = 3.67$ ,  $p < 0.1$ ). This reveals that there is a U-shaped relationship between economic distance and the option of acquisitions depending on the level of administrative distance. On the whole, our findings suggest that administrative distance has a moderating effect on the influence of cultural, geographic and economic distance on establishment mode choice, thus supporting Hypotheses 1, 2 and 3.

In order to better interpret our results, we plotted the interaction effects, as shown in Figures 1, 2 and 3. All of them illustrate the change on the likelihood of choosing acquisitions instead of greenfield investments when the explanatory and the moderating variables change from their low values (one standard deviation below the mean)

**TABLE 4** Logistic regression for establishment mode choice (with economic distance<sup>2</sup>)

Variables	Model 6b β	Model 7b β	Model 8b β	Model 9b β	Model 10b β	Model 11b β
<i>Predictor variables</i>						
Cultural distance (CD)	-2.049** (0.129)	-1.402* (0.246)	-1.110 (0.896)	-0.681 (0.506)	-1.073† (0.342)	-0.128 (0.880)
Administrative distance (AD)	0.982 (2.669)					
High-quality institutional environments (AD1)		0.792* (2.207)	-0.223 (0.800)	-11.426* (0.001)	16.134** (13.019)	8.996† (8.237)
Low-quality institutional environments (AD2)		2.434 (11.406)	0.863 (2.370)	3.142† (19.894)	4.342† (7.832)	4.898* (1.080)
Geographic distance (GD)	-0.905 (0.405)	-0.642 (0.526)	1.047† (2.848)	-1.310 (0.270)	0.117 (1.124)	-0.066 (0.936)
Economic distance (ED)	2.980† (19.678)	3.285 (26.713)	1.231 (3.424)	5.028† (17.633)	-3.261 (0.038)	-3.204 (0.041)
Economic distance <sup>2</sup> (ED <sup>2</sup> )	-0.392† (0.676)	-0.489† (0.613)	-0.497† (0.608)	-0.670† (0.512)	0.397 (1.488)	0.487 (1.628)
<i>Interactions</i>						
AD1xCD			0.557* (1.745)			0.562* (1.755)
AD1xGD				3.185* (20.078)		2.514* (12.357)
AD1xED					-2.334* (0.097)	-2.912** (0.054)
AD1xED <sup>2</sup>					3.676† (3.496)	4.636* (10.084)
<i>Control variables</i>						
Firm size	-1.203* (0.300)	-1.033** (0.356)	-0.896** (0.408)	-1.036** (0.355)	-0.824* (0.439)	-1.096** (0.334)
Host country acquisition exp.	0.068 (1.071)	0.073 (1.075)	0.090 (1.094)	0.063 (1.065)	0.106† (1.112)	0.076 (1.079)
Host country greenfield exp.	-0.041 (0.960)	-0.069† (0.933)	-0.096** (0.908)	-0.070† (0.933)	-0.071* (0.932)	-0.076* (0.926)
General international exp.	0.443 (1.558)	0.503† (1.654)	0.491† (1.635)	0.518† (1.678)	0.334 (1.396)	0.654 (1.923)
English language	0.847† (2.332)	0.554 (1.741)	0.480 (1.617)	-0.336 (0.715)	0.254 (1.289)	-0.546 (0.579)
Host knowledge	-0.023 (0.977)	0.008 (1.008)	-0.044 (0.956)	-0.040 (0.961)	0.058 (1.059)	-0.061 (0.941)
FDI restrictions	1.119* (0.977)	0.904† (2.469)	1.051* (2.860)	0.223 (1.250)	0.004 (1.004)	0.248 (1.281)
Industry effect	Yes	Yes	Yes	Yes	Yes	Yes
Year effect	Yes	Yes	Yes	Yes	Yes	Yes
Chi-square	62.600***	62.887***	64.293***	66.628	68.303***	77.570***
Cox R <sup>2</sup>	0.298	0.265	0.247	0.279	0.285	.316

Notes:

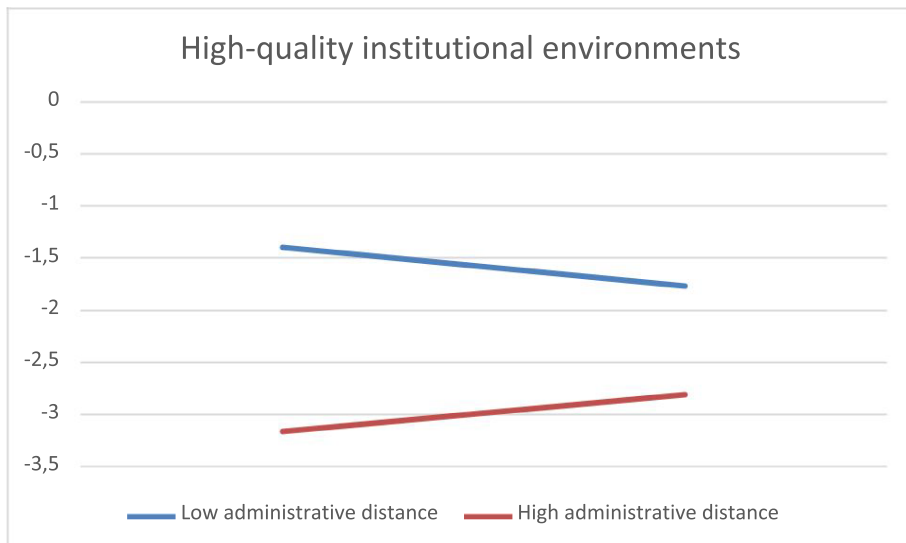
†p &lt; 0.1,

\*p &lt; 0.05, \*\*p &lt; 0.01, \*\*\*p &lt; 0.001. Standard errors are and reported in the parenthesis.

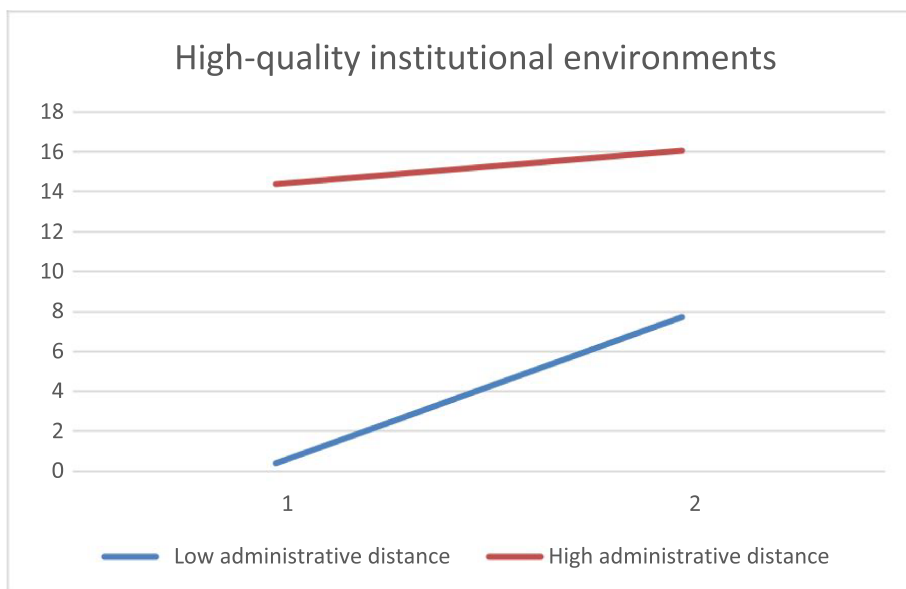
to their high values (one standard deviation above the mean), keeping all other variables at their mean level.

Figures 1 and 2 show that high administrative distance increases the likelihood of choosing acquisitions when there is a high cultural and geographic distance. In

Figure 3 economic distance affects the choice between acquisitions and greenfield investments differently. We observe a U-shaped relationship between economic distance and acquisitions for high levels of administrative distance and an inverted U-shaped relationship for low



**FIGURE 1** Interaction effect between administrative and cultural distance



**FIGURE 2** Interaction effect between administrative and geographic distance

levels of administrative distance. This provides additional support to Hypothesis 1, 2 and 3.

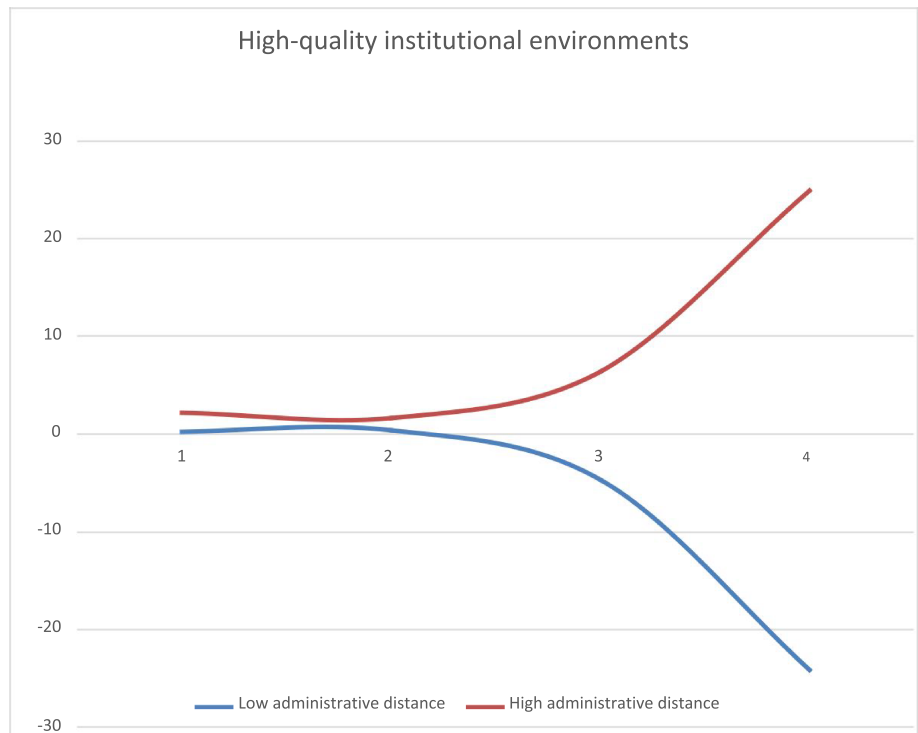
With regard to control variables, both host country greenfield experience and firm size have a negative effect on the choice of acquisitions, while FDI restrictions shows a positive effect in some models.

**Robustness checks**

We performed several robustness checks to assess the sensitive of our findings to model specifications (Lu & White, 2014). First, we excluded Infosys, the firm that accumulates the highest number of investments covered by our sample. After removing OFDIs carried out by this

company, we performed the regression analysis and the results were consistent with those reported in Table 3 and 4. Second, we excluded OFDIs in the US since this country received the most investments. As in the previous case, omitting this country did not change the results of our initial analysis. Finally, we proxied the cultural distance between India and each host country with an alternative indicator, which was used in prior studies (Beugelsdijk et al., 2018). We used the Euclidean distance. Hence, we created a composite index for each country. The new variable ranges from 129 (high cultural distance between India and each host country) to 1 (low cultural distance between India and each host country). The results were similar to those obtained in our main analysis.

**FIGURE 3** Interaction effect between administrative and economic distance



## DISCUSSION AND CONCLUSIONS

Distance factors represent important obstacles to MNEs when establishing in foreign countries since they limit strategic choices (Berry et al., 2010). TCE posits that distance factors have a negative influence on the preference for acquisitions because they increase the uncertainty associated with host countries (Anderson & Gatignon, 1986). Focusing on high commitment investments, this theory shows that high uncertainty will lead to transactional market failure, thus increasing likelihood of such high commitment investment modes (John & Weitz, 1988; Walker & Weber, 1987). Despite this, from an emerging market perspective, IT suggests that a high institutional quality in the host country may reduce some difficulties associated with distance factors, thus mitigating the liability of foreignness. We provide evidence that acquisitions are preferred by Indian MNEs, over greenfield, as establishment mode in high-quality institutional environments managing the uncertainty due to distance differently. This could explain why EMNEs opt for acquisitions instead of greenfield investments when they enter distant markets.

We hypothesized that administrative distance moderates the impact of cultural, geographic, and economic distance on EMNEs' preference for cross-border acquisitions instead of greenfield investments. An analysis of our data reveals that the vast majority of host countries with a higher administrative distance from India are developed countries, while most of those with a lower administrative distance are emerging markets. Hence,

administrative distance, for EMNEs, implies that they usually enter through acquisitions in more developed markets with high-quality institutions. Our findings support our three hypotheses.

First, we obtained that high administrative distance reduces the negative effect of cultural distance on acquisitions by Indian MNEs. As stated above, high host country's institutional quality can facilitate the communication between actors in an international scenario (Dow & Karunaratna, 2006; Hur et al., 2011). Our findings suggest that transaction costs associated with acquiring a firm in a culturally distant country may be reduced if there are high-quality local institutions.

Second, we obtained that Indian MNEs tend to prefer acquisitions as the establishment mode in countries with high institutional quality, that is, with higher administrative distance, despite the fact that those countries are geographically distant from India. Countries such as the US and the UK are traditional destinations of India's OFDI (Buckley et al., 2017). Thus, these are distant countries from a geographical point of view but, as developed countries, they have high-quality institutions that may reduce the difficulties perceived by Indian firms, leading them to establish through the acquisition of a local company.

Third, our findings also suggest a moderating effect of administrative distance on the relationship between economic distance and acquisitions, although with a U-shaped and an inverse U-shaped relationship. More precisely, we obtained that at high levels of administrative distance, the effect of economic distance on the

probability of choosing acquisitions is negative until some threshold, later turning to positive (U-shaped relationship). Conversely, at low levels of administrative distance, the effect of economic distance on the probability of choosing acquisitions is slightly positive until some threshold, later becoming negative (inverse U-shaped relationship).

Since economic distance is higher when Indian MNEs enter developed countries, our results support Tsang and Yip's proposal (2007), namely, that acquisitions are a more efficient way than greenfield investments to access strategic assets in developed markets. An interesting result regarding economic distance is that its effect is not always represented by a linear relationship (Malhotra et al., 2011). As Gaffney et al. (2016) propose, institutional dimensions may have nonlinear relationships with cross-border acquisitions, and more studies are needed to test such a curvilinear relationship.

### Contributions, limitations, and future research

This study contributes to our understanding of the factors influencing decision-making process of EMNEs in several ways. First, from a theoretical point of view, we contribute to TCE and IT by analyzing how administrative distance may reduce the transactions costs derived from cultural, geographic, and economic distance. We can conclude that distance affects differently depending on the home country of the MNE. In this way, the administrative distance plays a key role in the establishment mode decisions. The institutional quality of the country of investment could reduce the traditional negative effect of distance, changing the TCE dominant approach for developed-country MNEs towards greater prominence of IT in the case of EMNEs (Chikhouni et al., 2017). Consequently, IT provides a better explanation of the distinctive behavioral pattern of EMNEs when making decisions on establishment mode choice in foreign markets. We argue that a high level of administrative distance not always represents high uncertainty and costs for business activities because it offers an opportunity for institutional arbitrage. These EMNEs, still in the early stages of internationalization, are aggressively expanding into foreign markets to not only exploit their home-based experience, but also take advantage of strong and stable institutional environments in host markets (Cuervo-Cazurra et al., 2018; Wu et al., 2021). Legitimacy, institutional imperfection or institutional voids are key terms collected in the administrative distance, which influence in a different pattern in the case of EMNEs (Kostova & Marano, 2019). The institutional context matters and more studies focusing on different IB topics are needed from an emerging market perspective.

Second, from an empirical viewpoint, we provide a more complete analysis of factors influencing

establishment mode decisions of EMNEs by simultaneously analyzing the influence of the four types of distance. As stated above, prior studies mainly focused on a single distance factor and those considering the role played by host country's regulatory institutional quality are scarce. In this study we used the CAGE framework to analyze the influence of different distance factors on international decisions by EMNEs using one of them—administrative distance—to establish moderating relationships. The specific emerging market context is interesting because a higher administrative distance usually involves making decisions to establish in countries with higher institutional quality. The direction of that distance also matters and a higher administrative distance, considering high-quality institutional environments, mitigates the effects of different distance factors.

In addition, our study has managerial implications. Our results suggest that managers of EMNEs, when making decisions on establishment mode choice, should consider one important distance factor and its direction, related to the host country's regulatory institutional quality, the administrative distance between home and host countries. Institutional factors have a strong impact on decision-making process of EMNEs. Studies on institutional differences find that managers who identify such differences are in a better position to make decisions in international contexts (Hernández & Nieto, 2015; Schwens et al., 2011).

Some limitations arise that suggest potential future research directions. First, the secondary data sources used in our empirical research. Further research considering different measures of each distance factor and other firm-level variables might improve and consolidate the results we have obtained. Second, we only analyzed higher commitment establishment mode choices. Thus, future studies addressing other strategic choices by EMNEs are needed in order to further investigate the interplay between distance factors and the host country's regulatory institutional quality, that is, analyzing the preference for using a shared hierarchical mode (i.e., joint venture) to execute either an acquisition or a greenfield investment. Third, we focused on Indian MNEs. Therefore, to improve the generalizability of our findings, it would be interesting to analyze similarities and differences in the behavioral pattern of Indian MNEs and MNEs from other emerging markets. In future studies the idea is to enlarge and extend, and even replicate and compared issues examined in this study across a broader set of emerging markets, incorporating a larger sample of firms in order to account for unobserved variance from firm factors that are not controlled for. Finally, to provide a more useful tool for managers, future studies could expand the analysis by including performance differences. With this new variable, managers could know the implications of their establishment mode decisions, determining the factors that promote better performance for the MNE.

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