Institutional distance, establishment mode choice and international experience: the case of Indian MNCs

1. Introduction

In recent years, studies focusing on emerging market MNCs have become increasingly important. Although most studies on internationalization drew on the paradigms of developed economies, the resulting theories may need an adaptation in the case of emerging markets (Quer, Claver & Rienda, 2012). Emerging economies represent a new context with their own characteristics in terms of how their resources are configured when compared with developed countries; for example, firms from developing countries do not usually have the same ownership advantages as large MNCs from developed economies or they do not have the same experience as those in developed countries. Even some authors state that MNCs from emerging markets and MNCs from developed markets are in different stages of evolution as MNCs (Ramamurti, 2012).

Although our paper focuses on emerging markets, as Pradhan and Sauvant (2010) emphasize, India follows a different pattern in the case of emerging markets, this being more evident when comparing India with the other major emerging economy: China. Some scholars suggest that Indian OFDI does not represent a substantial challenge to conventional theory (Chen, 2012). Actually, the Indian economy presents some characteristics that are more related to developed markets such as its institutional environment, which is as liberal and business friendly as that of many developed countries, or its firms, that are sophisticated in terms of technology, operations, and management. Thus, it would be interesting to know if Indian MNCs follow the same behavior pattern of other emerging market MNCs or if they are closer to developed country MNCs.
Many international business researchers have focused on entry mode choice. A firm that decides to expand into foreign markets must decide between keeping and sharing control of its subsidiaries (Arregle, Hebert & Beamish, 2006). Also the firm must decide whether to acquire an existing local firm, through an acquisition, or to make a greenfield investment (Barkema & Vermeulen, 1998; Hennart & Park, 1993). In absolute terms, and as a proportion of total FDI, cross-border acquisitions have been increasing rapidly over the years (Anand & Delios, 2002).

Although there is a large number of papers focusing on entry mode choice in emerging markets (wholly-owned subsidiary vs. joint venture), papers analyzing decisions about ownership structure (acquisitions vs. greenfield) are more scant. This paper follows recent research efforts examining the factors that lead Indian firms to enter foreign markets through acquisitions, compared with the option of a start-up in the foreign country using greenfield investments (Buckley, Forsans & Munjal, 2012b; Duanmu & Guney, 2009; Nayyar, 2008; Pradhan & Abraham, 2004; Rangan & Parriño, 2008; Singh, 2009). Academic literature about the surge of cross-border investments of Indian companies is still quite scarce (De Beule & Duanmu, 2012) and as we point out in the theory and hypotheses section of this paper, empirical findings are not conclusive.

In this context, cultural distance and political risk are two of the most researched host country institutional factors (López & Vidal, 2010; Morschett, Schramm-Klein & Swoboba, 2010; Quer, Claver & Rienda, 2007). The vast majority of research papers dealing with these institutional factors focused on developed economies (Barkema & Vermeulen, 1998; Cho & Padmanabhan, 2005; Harzing, 2002; Kogut & Singh, 1988; Tihanyi, Griffith & Russel, 2005), some of them focused on emerging markets (Bhaumik & Gelb, 2005; Demirbag, Tatoglu & Glaister, 2008; Meyer, Estrin, Bhaumik & Peng, 2009; Quer et al., 2012; Rienda, Claver & Quer, 2013) and others compared developed and emerging markets (Malhotra, Sivakumar &
Zhu, 2011). In any case, mixed conclusions can be drawn when comparing the results from these prior studies.

Most papers about MNCs from developed countries suggest that when cultural distance or political risk are lower the MNC prefers to use acquisitions as an establishment mode in the host country (Agarwal & Rasmawami, 1992; Barkema & Vermeulen, 1998; Collins, Holcomb, Certo, Hitt and Lester, 2009; Harzing, 2002; Klein, Frazier & Roth, 1990; Kogut & Singh, 1988; Tihanyi et al., 2005). However, there are also papers reporting a non-significant relationship between cultural distance and the option of acquisitions (Brouthers & Brouthers, 2000; Cho & Padmanabhan, 1995; Demirbag et al., 2008; Meyer et al., 2009).

In the case of emerging markets, we found similar results when considering cultural distance. Most papers found a negative relationship between cultural distance and acquisitions (Aybar & Ficici, 2009; Bhaumik and Geld, 2005; Buckley et al., 2009). By contrast, in the case of India, cultural distance could not be a factor that affects these ownership decisions (Buckley et al., 2012b).

Regarding political risk, although we found few papers about this specific factor, there are also differences among emerging markets patterns. First, some papers report that, in the case of emerging market MNCs, there is no relationship between political risk and decisions about ownership structure (Duanmu, 2012; Duanmu and Guney, 2009; Quer et al., 2012). Indian firms have experience of operating within a home country environment which does not offer good socio-economic conditions as developed countries do. This is one of the reasons by which political risk in the host country may not be a significant factor in foreign acquisitions (Buckley, Forsans & Munjal, 2009). Nevertheless, the results reported by some prior research show that Indian MNCs tend to perceive and behave towards political risk in the manner that industrially advanced countries MNEs do and therefore political risk could affect decisions about ownership structure (Ionascu, Meyer & Estrin, 2004; Rienda et al., 2013; Munjal,
Forsans & Buckley, 2010). As we propose later, the interaction effects between different
variables might also explain the conflicting results obtained in previous research.

By considering that the country of origin also matters, some differences among
emerging market MNCs may arise. Besides, since empirical research focusing on emerging
market MNCs is scarce, more empirical studies are needed in order to analyze the influence of
cultural distance and political risk on some decisions. In the case of India, there are also
additional motivations for analyzing those institutional factors. First, since this is a country
with significant linkages to Western countries, it is interesting to know if the influence of
cultural distance is similar or not. Second, there is a lack of empirical evidence on the
relationship between political risk and establishment mode choice in the case of Indian
MNCs.

In order to fill this gap, the first aim of this paper is to analyze how cultural distance
and political risk affect the establishment mode choice of Indian MNCs. Furthermore,
dynamic learning capabilities are resource-based advantages that facilitate the adoption of
new capabilities and the adaptation of existing resources to changes in institutional
environments. For international ventures, empirical research suggests that international
experience may provide a firm with dynamic learning capabilities (Chang & Rosenzweig,
2001); both the intensity and diversity of international experience endow a firm with
resource-based advantages that can be used to exploit (or explore for) other resources in new
markets (Luo & Peng, 1999).

Recognizing international experience to be an important factor in explaining
international expansion, we focus on international experience interactions with sources of
uncertainty inherent in the host market. More specifically, our aim is to answer the following
question: Do MNCs from India prefer to enter institutionally distant countries through
acquisitions rather than through greenfield investments? Can international acquisition
experience moderate the relationship between cultural distance and the choice of acquisition as an establishment mode? Does the same apply for political risk?

In the following section we set out the literature review and hypotheses development. We next introduce a description of the methodology used, before presenting and interpreting the empirical results. Conclusions and future lines of research are presented in the final section.

2. Theory and hypotheses

Along with the dynamic learning perspective that is more related to firm’s international experience, we build on other theories that also fit with the proposed relationships between cultural distance, political risk and establishment mode choice. These theories are the resource-based view of the firm, the transaction cost theory and the institutional perspective.

In terms of resources, acquisitions are a mechanism generally used to exchange capabilities that would otherwise be impossible to use efficiently (Capron, Dussauge & Mitchell, 1998; Seth, 1990). Entry mode choice will depend on the relationship between the firm’s resource base and the new resources required by the market (Lee & Lieberman, 2010). This means that when the firm decides to enter another country, it can use its firm-specific capabilities in a host market through FDI. Nevertheless, this new competitive context can result in the need to reconfigure existing capabilities or acquire new ones (Zaheer, 1995). In this case, the firm may choose either to develop capabilities internally or buy them in the foreign market (Wernerfelt, 1984). If the firm needs to buy these new capabilities and they are difficult to find in the market due to information asymmetry or opportunism, acquisitions would be an efficient way to obtain these required capabilities. Otherwise, if the firm possesses those capabilities and has no incentive to acquire them, it can use them in the host country by a greenfield investment (Barkema & Vermeulen, 1998). As a result, the level and
nature of firm-specific advantages determine whether entry will be through acquisitions or greenfield investments (Hennart & Park, 1993; Meyer et al., 2009).

The internalization theory, building on transaction cost economics, analyzes opportunism problems, limited rationality and transaction costs, and it is complementary to the resource-based view of the firm (Anderson & Gatignon, 1986; Buckley & Casson, 1976, 1988). Firms will choose the entry mode that minimizes the transaction costs associated with exploiting a competitive advantage in a foreign market (Buckley & Casson, 1976; Dunning, 1988). Before acquiring a firm, two transaction costs need to be considered: those resulting from the valuation of the firm to be acquired, and the cost of integrating the acquired firm, as well as the possibility of acquiring unwanted assets. In general, these transaction costs increase with cultural or geographic distance, as obtaining information becomes more difficult (Kogut & Singh, 1988). Entry through greenfield investments involves lower transaction costs, and it is therefore considered a more efficient mode of structuring intra-organizational exchanges compared with acquisitions (Brouthers & Brouthers, 2000).

Finally, institutional factors play also a crucial role in entry mode decisions. According to the institutional perspective, institutions support how market mechanisms operate. Thus, institutional differences are highly significant for MNCs operating in multiple international contexts (Globerman & Shapiro, 1999; Meyer & Tran, 2006; Meyer et al., 2009). Formal rules make it possible to determine, for example, the entry mode allowed in each country, whereas informal rules may favor one particular mode over another (Peng, Wang & Jiang, 2008). They also provide additional information about possible partners and their behavior when establishing alliances. Essentially, a strong institutional framework equates to a lower cost in doing business (Bengoa & Sanchez-Robles, 2003; Bevan, Estrin & Meyer, 2004; Estrin, 2002) or greater market efficiency (Kedia, Mukherjee & Lahiri, 2006). Weak institutions reduce the possibility of choosing acquisitions due to a lack of transparency.
and information about host country’s firms (Lin, Peng, Yang & Sun, 2009). A weak institutional framework means increased costs and greater risk (Meyer et al., 2009). In emerging markets economies, institutions and institutional factors are particularly important because institutional weakness increases transaction costs and the level of risk that the firm must take on (Demirbag et al., 2008; Meyer & Peng, 2005).

Building on the above mentioned theoretical perspectives, next we propose several hypotheses regarding the role of cultural distance and political risk in establishment mode decisions.

2.1. Cultural distance and political risk

Cultural distance is a widely researched topic in the entry mode literature (Barkema, Bell & Penning, 1996; Demirbag, Glaister & Tatoglu, 2007). According to Kogut and Singh (1988) and Hofstede (1989), cultural distance indicates differences in terms of culture, economic systems, and business practices between a home country and each individual host country. Differences in cultural values between the home and the host country provide an additional level of uncertainty (Rothaermel, Kotha & Steensma, 2006). In addition, cultural similarities between home and host country reduce transaction costs (Taylor, Zou & Osland, 1998).

There are costs associated with acquiring information about the local firm and costs of monitoring this information (Erramilli & Rao, 1993). Coval and Moskowitz (2001) suggested that geographic and cultural proximity reduced the information costs about the acquisition. In other words, cultural distance increases information asymmetry, resulting in higher monitoring costs, and hampers the firm’s ability to transfer core competencies to foreign markets (Tihanyi et al., 2005). Considering this, when cultural distance is high, greenfield
ventures will be the preferred mode (Brouthers & Brouthers, 2000; Tihanyi et al., 2005; Zhao, Luo & Suh, 2004).

Furthermore, the greater the cultural distance, the higher the costs of transferring knowledge and technology (Almeida & Kogut, 1999; Kogut & Singh, 1988; Morschett et al., 2010). The acquired firm may even strongly resist knowledge transfer from the acquiring firm. In general, the larger the culture distance between the acquirer and the acquired unit, the more dissimilar and incompatible their practices and the more complicated their transfer (Cho & Padmanabhan, 1995; Hofstede, 1980, 1983; Schneider & De Meyer, 1991; Slangen, 2006). This argument has been supported by prior studies (Harzing, 2002; Kogut & Singh, 1988; Larimo, 2003).

In the case of emerging market MNCs, arguments based on the transaction cost theory and the resource based view of the firm also apply. If an emerging market MNC feels that it would find it difficult to understand the local norms (or be able to effectively monitor the local partner), it would prefer to choose a greenfield investment instead of an acquisition (Aybar & Ficici, 2009; Bhaumik and Geld, 2005; Buckely et al., 2009). Therefore, in the case of Indian MNCs, we propose that:

**Hypothesis 1:** The lower the cultural distance between India and the host country, the more likely that Indian MNC chooses to enter through acquisitions than through greenfield investments.

Political risk is also considered an important dimension of the institutional environment, particularly when the firm starts its internationalization process (Demirbag et al., 2007). If the host country shows higher levels of risk, it tends to have more inefficient markets and possible corruption problems (Estrin, 2002). Changes in a country’s political regime may result in taxes increasing, limiting or prohibiting the repatriation of firm profits,
or imposing exchange rate controls and restrictive technology licensing practices (Rothaermel et al., 2006).

While MNCs may be able to take advantage of market imperfections, they may also have to deal with the high costs of uncertainty associated with these countries (Aybar & Ficici, 2009; Quer et al., 2012). Moreover, transactions costs increase with bounded rationality, which makes it difficult to anticipate all possible contingencies. For this reason, greenfield investments as establishment mode choice may help to reduce external uncertainty in high-risk countries (Kogut & Singh, 1988; Klein et al., 1990). Furthermore, the resource-based view suggests that firms will prefer to preserve their resources by opting for internal development to avoid opportunism and to maintain control over the subsidiary (Agarwal & Ramaswami, 1992). Therefore, when uncertainty is high, firms will not opt for acquisitions (Morschett et al., 2010).

Some additional arguments may apply in the case of emerging markets. We find empirical evidence suggesting that host country risk does not affect entry mode choice of emerging market MNCs in a conventional way (Duanmu, 2012; Duanmu & Guney, 2009; Quer et al, 2012). Although some papers report that OFDI is negatively associated with high levels of political risk, others even report that some countries, like China, tend to invest in countries with higher levels of risk (Kang & Jiang, 2012; Malholtra & Zhu, 2009; Ramasamy, Yeung & Laforet, 2012).

However, in the case of Indian MNCs, there are few empirical studies focusing on the relationship between political risk and establishment mode choice, the vast majority of them being also descriptive. Some papers found that political stability seems of no concern as Indian MNCs invest more in politically risk countries and that corruption is not a major concern either, given that they are accustomed to similar circumstances in their home country (De Beule, 2010). Nevertheless, most papers show that the main acquisitions from Indian
MNCs are mainly concentrated in developed markets where the risk is lower than in emerging ones (Chen, 2012; Pradhan & Sauvant, 2010; Satyanand and Raghavendran, 2010).

As a result, we consider, in line with the above mentioned arguments, that Indian MNCs may follow a behavior pattern more similar to that of developed country MNCs. Thus, we propose:

**Hypothesis 2:** Indian MNCs prefer to enter the host country through acquisitions than through greenfield investments when there is a lower host country risk.

### 2.2. The moderating effect of international acquisition experience on cultural distance

The international experience accumulated by the firm is a factor that may affect the choice between acquisitions and greenfield investments. According to the knowledge-based view of the firm (Kogut & Zander, 1993; Madhok, 1997), these decisions are influenced by firm’s experience. Through a process of accumulated experience, MNCs develop familiarity with local environments in which they operate, which reduces the effects of distance and supports the incremental experience of Uppsala’s model (Johanson & Vahlne, 1977; 1990). Because of this experience, firms will create organizational routines and knowledge that they can use in future investments, particularly if the investment is in the same country (Brouthers & Brouthers, 2000; Cho & Padmanabhan, 1995).

Institutional distance has severe difficulties for the acquirer (Elango, Lahiri & Kundu, 2013). Understanding the institutional differences and adjusting to them may modify the risks and costs of transaction (Dikova, Sahib & Van Witteloostuijn, 2010). Thus, international experience may mitigate the negative effects of cultural distance and country risk on the likelihood of market entry by acquisitions.

In the case of cultural distance, as mentioned above, many papers argue a relationship between low cultural distance and acquisitions. Nevertheless, as Slangen and Hennart (2008) suggest, MNCs do not always enter culturally distant countries through greenfield
investments. Even some studies found that no significant relationship exists between cultural
distance and the entry mode chosen (Brouthers & Brouthers, 2000; Cho & Padmanabhan,
1995; Demirbag et al., 2008; Padmanabhan & Cho, 1999; Tihanyi et al., 2005).

In the case of India, a major source of ownership advantages for Indian firms is the
know-how held by the Indian diaspora abroad (Balasubramanyam & Forsans, 2010). As
Buckley et al. (2012b) pointed out, “Indian expatriates act as cultural bridges to countries that
are seemingly distant, thus ameliorating cultural distance”. Moreover, we found that the
relationship between cultural distance and Indian acquisitions might not be significant due to
lack of economic integration and political rivalry within the South Asian countries (Buckley
et al., 2012b; Rienda et al., 2013). Asia is very diverse, India does not have good relationships
with all its neighboring countries, and religious differences have to be considered as well.

Some other factors may reduce the risk of cultural incompatibility or the costs of
information and control. Previous experience in the host country may attenuate the effects of
cultural distance, allowing the peculiarities of the local culture to be learned and reducing
some problems that may arise due to the lack of information (Barkema & Vermeulen, 1998;
Li, 1995). Through international acquisitions, firms will be able to tap the different routines
that are embedded in national culture (Morosini, Shane & Singh, 1998). With such learning,
firms will reduce risk by using prior experiences to draw inferences and applying them in the
future (Levitt & March, 1988). Taking into consideration the aforementioned, we should
therefore point out that local experience may help to reduce the risks associated with entry
into culturally distant countries, which would lead MNCs to choose acquisitions, despite the
wide cultural gap. These lead us to propose:

**Hypothesis 3:** The higher the Indian MNCs’ prior international acquisition
experience, the higher the likelihood that it will choose to enter culturally distant countries
through acquisitions than through greenfield investments.
2.3. The moderating effect of international acquisition experience on political risk

Past research studies focusing on Indian MNCs are scarce and reported not conclusive results. On the one hand, some studies found that a lower host country political risk has a significant positive influence on acquisitions (Ionascu et al., 2004; Rienda et al., 2013). On the other hand, Buckley et al. (2009) suggested that political risk in the host country might not be a significant factor in cross-border acquisitions, for reasons such as India’s experience and ability to work in such environments.

Research on entry mode choice emphasizes the role of firm’s international acquisition experience in this context (Barkema & Schijven, 2008; Dikova et al., 2010; Elango et al., 2013; Finkelstein & Halebian, 2002). Firms with greater international experience in a given environment should possess a greater appreciation of the political risk of this country. It can provide an advantage in discerning the identity and preferences of the political actors. The effect of institutional differences might be ameliorated by learning from past acquisitions attempts (Dikova et al., 2010). Therefore, experienced firms are in a better position to react to changes in the political environment (Henisz & Delios, 2004). Thus, we propose:

**Hypothesis 4:** The higher the Indian MNCs’ prior international acquisition experience, the higher the likelihood that it will choose to enter higher political risk countries through acquisitions than through greenfield investments.

3. Data and methodology

3.1. Sample

India is a large and strategically important democratic country with a growing service sector and significant industrial capabilities. It has the second largest population in the world and is one of the major economic powers in Asia. The economy of India is the ninth-largest in the
world by nominal gross domestic product (GDP), with about US$ 2,048 trillion, and the third-largest by purchasing power parity (PPP), with about US$ 7,384 trillion.

The period from 2000 to 2007 has been described as the arrival of Indian firms in developed countries and the expansion of Indian investments abroad (Singh & Jain, 2009). Since 2001, understanding the process of the emergence of Indian companies as global players has attracted the attention of both academics and policy-makers. In 2012, Indian companies were engaged in ambitious outbound merger and acquisitions with 72 deals abroad accounting for US$ 11 billion (UNCTAD, 2013). Overseas investments have been primarily driven by resource-seeking, market-seeking or strategic asset-seeking motives.

It is difficult to find complete data and information on cross-border acquisitions from India. The Reserve Bank of India (RBI), the primary source of data on OFDI, does not compile cross-border acquisitions data at firm level. Therefore, information on the specific establishment modes used by Indian MNCs has to be obtained from press reports or from websites (Nayyar, 2008). For this reason, our study focuses on the companies of the Tata Group, one of the most representative MNCs in India. The Tata Group publishes specific official data on its corporate website regarding investments made both in India and abroad.

The Tata Group plays a central role in the Indian economy (Goldstein, 2008). This group has been studied and used as an example in many research works focusing on Indian MNCs (Balasubramanyam & Forsans, 2010; Das, 2007; Gaur & Kumar, 2009; Kumar, 2007; Nayyar, 2008; Pradhan & Abraham, 2004; Rangan & Parriño, 2008; Schiele, Harms & Banerjee, 2014; Singh & Jain, 2009).

What makes the group peculiar, if not unique, is the fact that it is more than a simple financial holding, as it also centrally manages the Tata brand and provides high-level training (Goldstein, 2008). We chose this large business group for various reasons. First, because Tata is one of the largest emerging market MNCs, and some of its firms are listed in prestigious
business rankings such as Fortune Global 500 and Forbes. On the other hand, the Tata Group has a high level of unrelated diversification (Kedia et al., 2006). Thus, the second reason for choosing Tata is that it is a large conglomerate of firms operating in different sectors, which may be of interest, as the behavior of each individual firm can provide relevant information when considered as a whole. Finally, Tata’s outlook has been outward-oriented from the very beginning and it has an extensive international experience with operations in many countries.

In order to test the hypotheses, entries into foreign markets by Tata Group firms from 2000 to 2010 were selected for analysis. Data were obtained from various secondary sources. Data on each OFDI were obtained from the corporate website of Tata Group (www.tata.com). In order to enhance data reliability, we consulted other data sources, including the Centre for Monitoring Indian Economy, the Financial Times, the Business Standard, the Indian Express, Business Online India, and The Hindu Business Line. The final sample covered 114 OFDIs into 37 countries.

3.2. Dependent variable

The dependent variable was the establishment mode chosen for each OFDI, i.e. acquisitions or greenfield investments. Following Anand and Delios (2002), Barkema and Vermeulen (1998), Cho and Padmanabhan (1995), Hennart and Park (1993), Lee and Lieberman (2010), Rienda et al. (2013) and Slangen and Hennart (2008), a dummy variable takes a value of 1 if the company made an acquisition, and a value of 0 if it established a greenfield plant. In our paper we have considered as acquisitions only those representing more than 75% of equity shares. This allows us a more accurate comparison with greenfield investments in terms of risk involvement.

3.3. Independent variables

Cultural distance. We measured the cultural distance between India and each host country using the methodology developed by Kogut and Singh (1988), based on Hofstede (1980),
which established four dimensions of national culture: individualism, uncertainty avoidance, power distance, and masculinity/femininity. Countries with values close to 0 for cultural distance are culturally similar to India; high values mean a greater cultural gap with India. This variable has also been used by Aybar and Ficici (2009), Barkema and Vermeulen (1998), Cho and Padmanabhan (1995), Demirbag et al. (2007, 2008), Rothaermel et al. (2006), Slangen (2006), and Slangen and Hennart (2008).

**Political risk.** This variable was measured using the political risk ratio provided by the International Country Risk Guide report (PRS, 2010), which contains 22 variables in three categories of risk (political, financial and economic). PRS provides a separate index for each category. We focus on the Political Risk Rating, which includes 12 weighted variables covering both political and social attributes. In this rating, the higher a country’s score, the lower its risk. To enhance the interpretability of the results, we inverted the score to obtain a positive correlation between a country’s score and its risk. Once that variable was inverted, the higher the score, the greater the country’s risk. This procedure does not affect the distribution of the variable, merely its sign. Previous research has also used this ratio (Buckley et al., 2007, 2009; Duanmu & Guney, 2009; Quer et al., 2012).

3.4. **Moderator**

**International acquisition experience.** We argue that this variable moderates the relationships between cultural distance, political risk, and establishment mode choice. International acquisition experience was measured using the number of previous acquisitions in the particular host country (Barkema & Vermeulen, 1998; Elango et al., 2013; Kogut & Singh, 1988; Meyer et al., 2009; Slangen & Hennart, 2008). This information was obtained from each Tata firm’s annual reports published on its corporate website.

3.5. **Control variables**
General international experience. Other types of firm’s prior international experience may also affect establishment mode decisions. If the company is already operating in several countries it may accumulate a general international experience that may be useful in further entries. Thus, we considered cumulative international experience as a control variable. Following Kogut and Singh (1988), Meyer et al. (2009), and Slangen and Hennart (2008), cumulative international experience was measured through the number of host countries in which each Tata firm has OFDI. This information was obtained from each Tata firm’s annual reports on its corporate website and from different secondary sources.

Firm size. Firm size is a significant factor influencing international operations (Caves, 1996). In the case of Indian MNCs, firm size seems to have a positive effect on the likelihood that the firm will decide to invest in a foreign market (Kumar, 2007). Moreover, transaction cost theory predicts a close relationship between firm size and the establishment mode, mainly through acquisitions, although empirical evidence is not conclusive. Thus, we controlled for firm size using firm revenues in the year prior to entry. Then, we performed logarithm transformation of firm’s revenues to enhance the normality of the distribution (Barkema & Vermeulen, 1998; Cho & Padmanabhan, 1995; Gaur & Kumar, 2009).

Industry. There may be industry differences in the preference of acquisitions as an entry (Erramilli & Rao, 1993; Kogut & Singh, 1988; Morosini et al., 1998). To determine the industry each company belongs to, we created a variable with two categories: 1, manufacturing industry, and 0, service industry.

Market size. The GDP growth of the host country in the year prior to entry was used to measure market size (Barkema & Vermeulen, 1998; Duanmu & Guney, 2009). This information was obtained from the World Bank database. We used logarithm transformation to normalize the distribution of this variable (Buckley et al., 2007).
Objective: strategic assets. The specific objective of each OFDI decision (looking for resources, markets, or strategic assets) may influence these results (Buckley et al., 2009). Given that many emerging market MNCs invest abroad to access advanced technology and managerial know how, we included a dummy variable regarding the objective of each OFDI decision: 1 if strategic-asset seeking and 0, otherwise.

Language familiarity. India is culturally close to some Western countries such as the US and the UK due to the proximity of the English language and the historic memory of India as a British colony. Greater familiarity with the language would therefore be one of the factors affecting our results. Thus, we controlled for language familiarity by a dummy variable which takes value 1 if English is the host country’s official or primary national language and 0 otherwise. This variable is also used in other papers focusing on India (Buckley, Enderwick, Forsans & Munjal, 2012a; Buckley et al., 2012b).

Table 1 summarizes the operationalization of the variables and sources of data used.

4. Statistical method and results
To examine the statistical relationship between the individual predictor variables and establishment mode choice, we employed a logistic regression analysis. The dependent variable represents the differential probabilities of choosing one alternative (acquisitions) relative to another (greenfield investments).

Hypotheses of this paper suggest that if cultural distance and political risk are lower, Indian MNCs prefer to opt for acquisitions as an establishment mode choice; and that international acquisition experience moderates the relationship between cultural distance, political risk and establishment mode choice. Moderated regression is considered a relatively conservative method for examining interaction effects. Moderation effects are supported if the
model covering the interaction terms represents a statistically significant improvement over the model containing the direct effects only (Baron & Kenny, 1986).

Our review of correlation values among variables indicated that there was no particular concern for multicollinearity issues. An examination of the variance inflation factor (VIF) values showed that all values ranged between 1.06 and 2.39, which are well below the standard cut-off level of 10. Table 2 shows standard summary statistics and bivariate correlations.

Insert table 2 about here

From the sample of 114 OFDIs, 59 were acquisitions and 55 were greenfield investments. As occurred in previous studies on Indian MNCs (Balasubramanyam & Forsans, 2010; Pradhan, 2008; Pradhan & Abraham; 2004; Singh & Jain, 2009), the main host countries were the US (15 entries), and the UK and South Africa, with 11 entries each. If we analyze acquisitions alone, the US comes first, with 12 out of the 59 acquisitions, followed by the UK with 10, and Australia with 5 acquisitions.

Table 3 summarizes the regression results. We used different models, all of them being statistically significant. Model 1 performed the regression considering only control variables. Models 2-8 were used to test the hypotheses and included several combinations of independent variables, moderator, interaction effects and control variables.

Insert table 3 about here

We tested hypotheses 1 and 2 on direct effects using model 2 (including only independent variables and the moderator), model 3 (including independents variables, the moderator and control variables) and model 8 (including all variables). Hypothesis 1 proposes that Indian MNCs prefer to enter the host country through acquisitions when cultural distance between India and the host country is lower. The regression results of models 2, 3 and 8 show
that no significant relationship exists between cultural distance and establishment mode choice. Therefore, hypothesis 1 is not supported.

A possible explanation for this result could be derived from the measure we used for cultural distance. Although it is a measure widely used in entry mode research, it could leave out some important issues in the case of India such as its historical links with some host countries. Anyway, as we pointed out above, there is no conclusive empirical evidence about the assumption that greater cultural similarity was positively related to acquisitions. Several studies even found just the opposite relationship (Barkema et al., 1996; Barkema & Vermeulen, 1998) or did not report a significant effect (Brouthers & Brouthers, 2000; Buckley et al., 2012b; Cho & Padmanabhan, 1995; Ionascu et al., 2004; Tihanyi et al., 2005). Meyer et al. (2009) failed to find a significant relationship for a group of firms from emerging countries, including India. Rienda et al. (2013) did not find a significant relationship between cultural distance and acquisitions for Indian MNCs either. Demirbag et al. (2008) reported a similar result for a group of Turkish MNCs.

Hypothesis 2 proposes that Indian MNCs prefer to enter the host country through acquisitions when there is a lower host country political risk. Thus, when there is greater risk involved, firms perceive a greater uncertainty and will prefer to opt for internal development trying to avoid possible opportunism or transfer of know-how to competitors (Mudambi & Mudambi, 2002). Regression models 2, 3 and 8 report a negative direct effect of political risk on the choice of acquisitions. Thus, hypothesis 2 is supported. Although some papers found that emerging market MNCs tend to invest in countries with higher levels of risk (Kang & Jiang, 2012; Malhotra & Zhu, 2009; Ramasamy et al., 2012), we found that Indian MNCs follow the more conventional behavior of developed country MNCs.

Hypothesis 3 suggests that international acquisition experience moderates the negative relationship between cultural distance and the probability of choosing acquisitions. We tested
this hypothesis using model 4 (including cultural distance, international acquisition experience and the interaction between them), model 5 (including political risk and control variables as well) and model 8 (with all variables). The results reported in these regression models show a positive interaction effect between cultural distance and international acquisition experience, thus supporting hypothesis 3. This finding suggests an alternative explanation for the lack of significance of the direct effect of cultural distance (hypothesis 1). This may also be due to the influence of linkages and prior experience on perceived cultural distance. Hence, with international acquisition experience, firms would reduce the cultural barriers through learning (Chatterjee 1990; Li 1995).

To further examine the impact of international acquisition experience, next we analyze the marginal effects. First, we insert in the equation model the actual values of coefficients (model 5, table 3) and then take the first derivative of equation with respect to international acquisition experience, holding all other explanatory variables constant. Thus, the overall impact of cultural distance on the propensity to choose acquisitions is negative when the international acquisition experience is low but turns positive for high values of this experience. Figure 1 illustrates the relationship between cultural distance and establishment mode choice for both low (i.e., one standard deviation below the mean) and high (i.e., one standard deviation above the mean) values of international acquisition experience, keeping all other variables constant at their mean value.

**Insert figure 1 about here**

In line with our prediction, figure 1 shows that cultural distance has a positive effect on acquisition choice at high levels of international acquisition. When acquisition experience in the host country is high, MNCs may reduce the uncertainty associated to these countries and they are likely to choose acquisitions, even when the cultural distance is high, as predicted in hypothesis 3.
Hypothesis 4 posits that international acquisition experience moderates the negative relationship between political risk and the probability of choosing acquisitions. This hypothesis was tested using model 6 (including political risk, international acquisition experience and the interaction between them), model 7 (including cultural distance and control variables as well) and model 8 (with all variables). As depicted in these regressions, the interaction term between political risk and international acquisition experience is positive, thus providing support for hypothesis 4.

Figure 2 plots the relationship between political risk and establishment mode choice for various levels of international acquisition experience. We suggest that a greater international acquisition experience may help to learn about the institutional environment even when acquisitions are in countries with a higher political risk. If the MNC possesses a greater experience about acquisitions, the probability of choosing acquisitions is higher. Therefore, political risk has a negative effect on acquisition choice at low levels of international acquisition experience.

Insert figure 2 about here

5. Discussion and conclusion

The concept of “distance” has been used by international business scholars to explain variations in international business strategies across countries (Ionascu et al., 2004). The international environment includes different sources of uncertainty (Henisz & Delios, 2004). We focus on two important sources of this uncertainty, namely, cultural distance and political risk. These two variables, together with the effect of the experience as a moderator variable in the establishment mode choice decision are the main core of this paper. Previous research has shown that country similarities influence entry mode choice. Therefore, differences between host and home country contexts are highly relevant for international business strategies. This
is particularly important when studying international business strategies in developing countries.

The question of how firms choose the establishment mode in different host markets has attracted sustained attention among international business scholars (Elango et al., 2013). As we pointed out in the introduction section, research on the establishment mode choice of Indian MNCs is quite scarce. To address this gap, we focus on these MNCs and their international expansion process. In this context, our main theoretical premise is that international market entry decision by Indian MNCs is based on balancing perceived risks inherent in foreign markets. We proposed a model predicting establishment mode choice by Indian MNCs in which cultural distance and political risk, two important institutional variables, have a negative direct effect on the likelihood of choosing acquisitions as an establishment mode. In a next step, we added international acquisition experience as a moderator variable. We suggested that perceived sources of uncertainty are moderated by international acquisition experience of the Indian MNC. More precisely, we pointed out that the acquisition experience in the host market reduces the negative direct effects of cultural distance and political risk.

Our findings will serve to provide insights on how firms seek the best establishment mode that allow for efficient integration of home and host units, using internal learning through experience while managing external institutional risk in dealing with foreign market settings. The potential advantage of past firm’s acquisition experience in the host market makes managers to accept the uncertainty inherent in high-risk or culturally distant countries. Therefore, we expected that even in highly distant institutional environments an increasing acquisition experience by MNCs raise their propensity to acquire local firms (Slangen & Hennart, 2008). Our findings suggest that acquisition experience moderates the relationships between cultural distance, country risk, and establishment mode choice.
From a theoretical point of view, these findings allow us to extend the knowledge-based view of the firm (Kogut & Zander, 1993; Madhok, 1997) and the dynamic learning perspective (Barkema & Vermeulen, 1998). This study validates the notion that firm experience in conducting acquisitions in a particular country impacts subsequent establishment mode decisions in markets that are institutionally distant. Slangen and Hennart (2008) pointed out that MNCs have a higher preference for acquisitions in culturally-distant countries when they have international experience. In our case, we focus on international acquisition experience by country and our results show that MNCs learn from their previous acquisitions (Vermeulen & Barkema, 2001). Moreover, in the case of India, there are few research studies dealing with political risk as a variable that influences establishment mode choice. Thus, our study has shed light on this issue.

Methodologically, this paper has provided new empirical evidence for a research topic that has received little attention in the case of emerging economies. In recent years, some scholars have attempted to explain the internationalization process of Indian firms from a macro vision of their OFDIs (Balasubramanyam & Forsans, 2010; Nayyar, 2008; Pradhan, 2008; Rangan & Parriño, 2008; Singh & Jain, 2009). However, these studies emphasize how important acquisitions are as establishment modes, although generally from a descriptive approach.

This paper has also some managerial implications. Our findings show that previous acquisition experience in a host country is a significant variable when making establishment mode choice decisions. Firms having previous acquisition experience can choose acquisitions as a preferred establishment mode in future investments, once they have developed processes and procedures to handle effective integration of an acquisition, as well as the ability to avoid common difficulties involved in such transaction (Elango et al., 2013). The firm can use their experience to learn about the host country institutional environment and it can try to use this
experience to gain advantages in markets where both cultural distance and political risk are high. Managers could be more willing to accept uncertainty stemming from cultural distance and political risk when they have previous experience in the host market. More precisely, acquisition experience in a country will allow the firm to manage the targets better, face lower cost due to minimized liabilities of foreignness, and potentially avoid underestimating the difficulties in managing differences in politics and national culture of the host country (Barkema & Vermeulen, 1997; Elango et al., 2013).

Despite the above mentioned contributions, this study contains several limitations, which in turn provide opportunities for future research. The first limitation concerns the variables included in our model. We measured cultural distance using the Kogut and Singh (1988) index, which has come up insignificant in some earlier studies (Buckley et al., 2012b). A potential problem about this measurement lies in the fact that, for some countries, no indicators in the index are available. We tried to overcome this difficulty by assigning these countries the score of others supposed to be culturally similar (Erramilli, 1991). Future studies using alternative measures of cultural distance could lead to different results. For example, similarly to what Buckley et al. (2007) did in the Chinese context, cultural proximity to India could be proxy by the percentage of ethnic Indian in the host population. In addition, as Rothaermel et al. (2006) proposed, future research could focus on the individual dimensions of national culture to produce richer theoretical models.

Furthermore, lack of data prevented us from including other variables that may also affect establishment mode choice, such as the existence of desired assets in the host country. If prior research has studied mostly Western MNCs, for which culturally distant markets tend to be emerging and might not even have assets that can be acquired, then finding a negative association between cultural distance and the choice of acquisition over greenfield investment would not be surprising. For Indian companies investing in Western markets, the reverse
might likewise be true. Thus, more in depth studies are needed in order to analyze the influence of the availability of desired assets in the host country on establishment mode choice.

Another limitation refers to the data used. Our empirical research is based on secondary data, a fact that influences the measurement of the variables. This prevented us from including managerial perceptions. Future studies could achieve a more in-depth understanding of the establishment mode choice of Indian MNCs by detailed surveys on managerial decision-making processes, including primary information from both the parent firm and the foreign subsidiaries.

Finally, when interpreting our results, it should be pointed out that our sample is based on the international operations of Tata Group companies. Although this is one of the most active Indian corporations in international markets, collecting information from more companies would increase the generalizability of our results. In this line, future research focusing on other Indian firms may lead to a deeper knowledge of OFDI decisions by Indian MNCs.

References


The centered cultural distance values in our sample range from -1.86 to 3.21.
The centered political risk values in our sample range from -1.54 to 3.05.
<table>
<thead>
<tr>
<th>Variable</th>
<th>Definition</th>
<th>Source</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cultural distance</td>
<td>Kogut and Singh (1988) index was used to compute cultural distance between the home and the host country across the four cultural dimensions of Hofstede.</td>
<td>Hofstede (1980)</td>
</tr>
<tr>
<td>Political risk</td>
<td>Difference in country risk scores between home and host country</td>
<td>International Country Risk Guide (PRS, 2010)</td>
</tr>
<tr>
<td>International acquisition experience</td>
<td>Number of acquisitions carried out by the Indian firm in the host country</td>
<td>Firm’s annual report and several secondary sources</td>
</tr>
<tr>
<td>General international experience</td>
<td>Number of host countries in which each Indian firm has OFDI</td>
<td>Firm’s annual report and several secondary sources</td>
</tr>
<tr>
<td>Firm size</td>
<td>Logarithm of firm revenues in the year prior to entry</td>
<td>Firm’s annual report and several secondary sources</td>
</tr>
<tr>
<td>Industry</td>
<td>(1) If the firm belongs to a manufacturing sector; (0) otherwise</td>
<td>Firm’s annual report</td>
</tr>
<tr>
<td>Market size</td>
<td>Logarithm of GDP growth for the host country in the year prior to entry</td>
<td>World Bank</td>
</tr>
<tr>
<td>Objective: strategic assets</td>
<td>Specific objective of each OFDI decision: (1) if strategic asset seeking; (0) otherwise</td>
<td>Firm’s annual report and several secondary sources</td>
</tr>
<tr>
<td>Language familiarity</td>
<td>Familiarity with the language between home and host country: (1) if English is the host country’s official or primary national language; (0) otherwise</td>
<td>CIA World Factbook 2014</td>
</tr>
</tbody>
</table>
Table 2
Descriptive statistics and correlations

|                          | Mean | SD  | 1    | 2    | 3    | 4    | 5    | 6    | 7    | 8    | 9    |
|--------------------------|------|-----|------|------|------|------|------|------|------|------|------|------|
| 1. Establishment mode choice | 0.52 | 0.50 |      |      |      |      |      |      |      |      |      |      |
| 2. Cultural distance     | 1.09 | 0.58 | 0.37**|      |      |      |      |      |      |      |      |      |
| 3. Political risk        | 59.25| 9.57 | -0.39**| -0.65**|      |      |      |      |      |      |      |      |
| 4. International acquisition experience | 2.13 | 2.14 | 0.33**| 0.33**| -0.32**|      |      |      |      |      |      |      |
| 5. General international experience | 19.92 | 6.80 | -0.05 | -0.00 | 0.34**|      |      |      |      |      |      |      |
| 6. Firm size             | 3.70 | 0.74 | -0.12 | 0.19* | -0.10 | 0.26**|      |      |      |      |      |      |
| 7. Industry              | 0.54 | 0.50 | 0.24**| -0.08 | 0.10  | 0.00  | 0.23* | 0.14 |      |      |      |      |
| 8. Market size           | 1.44 | 0.74 | -0.31**| -0.40**| 0.26**| -0.39**| -0.02 | 0.04 | 0.01 |      |      |      |
| 9. Objective: strategic assets | 0.49 | 0.50 | 0.38**| 0.20**| -0.37**| 0.22**| 0.10* | -0.02 | 0.05 | -0.12 |      |      |
| 10. Language familiarity | 0.45 | 0.50 | 0.21* | 0.24**| -0.43**| 0.47**| -0.14 | -0.13 | -0.11 | -0.32**| 0.15 |      |

N=114

*p<0.05; **p<0.01
Table 3
Logistic regression results

<table>
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<tr>
<th>Variables</th>
<th>Model 1</th>
<th>Model 2</th>
<th>Model 3</th>
<th>Model 4</th>
<th>Model 5</th>
<th>Model 6</th>
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<td>(0.643)</td>
<td>(1.210)</td>
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<tr>
<td>Political risk</td>
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<td>-0.061†</td>
<td>-0.052</td>
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<td>-0.115*</td>
<td>-0.198**</td>
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<td>(0.637)</td>
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<td>(0.024)</td>
<td>(0.060)</td>
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<tr>
<td>International acquisition experience</td>
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<td>(0.016)</td>
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<tr>
<td>Cultural distance*International acquisition experience</td>
<td>0.030†</td>
<td>0.973*</td>
<td>0.007**</td>
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<td>(0.016)</td>
<td>(0.003)</td>
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<td>(0.001)</td>
<td>(0.506)</td>
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<td>Political risk*International acquisition experience</td>
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<td>0.002†</td>
<td>0.005*</td>
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<td>-0.121</td>
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<td>(0.406)</td>
<td>(0.400)</td>
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<td>(0.434)</td>
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<td>1.898***</td>
<td>1.754**</td>
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<td>(0.514)</td>
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<td>Market size</td>
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<td>0.366</td>
<td>0.191</td>
<td>0.370</td>
<td>0.398</td>
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</table>

N=114
Robust standard errors in parentheses
†p<0.1, *p<0.05, **p<0.01, ***p<0.001