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**OWNERSHIP MODE, CULTURAL DISTANCE AND THE EXTENT OF PARENT FIRMS'  
STRATEGIC CONTROL OVER SUBSIDIARIES IN THE PRC**

**ABSTRACT**

Previous studies often associated a specific type of ownership mode with the extent of strategic control a parent firm may have over strategic decision in a foreign subsidiary, suggesting that parent firms should have higher control over wholly-owned subsidiaries (WoS) than international joint ventures (IJVs).

Building on multiple agency theory, we argue that higher ownership modes have a negative effect on the extent of control over the foreign subsidiary. In addition, we argue that cultural distance between the parent firm and the subsidiary moderates this relationship. We test our hypothesis using data from a sample of 156 foreign subsidiaries in the People's Republic of China (PRC) and find strong support for our arguments. Our findings show that in WoS parent firms reduce their extent of strategic control, while in IJVs parent firms increase their extent of strategic control. Moreover, we find that extent of control over WoS (IJVs) declines (increases) when cultural distance increases. Our results have significant theoretical implications for international business (IB) research as they challenge existing views with regard to the relationship between ownership mode and control as well as the moderating effect of cultural distance.

**Keywords:** Ownership mode, Cultural distance, Control.

## INTRODUCTION

MNCs increasingly face challenges associated with balancing the needs to control strategic decision-making of their subsidiaries in the far-flung foreign markets on one hand, and pressures for local adaptation to the specific institutional and economic characteristics of culturally distant locations on the other (Doz & Prahalad, 1984). Previous studies have analyzed these complex relationships between a parent firm and its foreign subsidiary in terms of the level of control the former exerts over the latter in the context of entry mode research (Anderson & Gatignon, 1986), subsidiary mandate (Birkinshaw, Hood, & Jonsson, 1998, Cray, 1984, Doz & Prahalad, 1981, Garnier, 1982, Gates & Egelhoff, 1986), agency theory (O'Donnell, 2000) or expatriate (Kobrin, 1988) research streams. Specifically, the level of control has been viewed as a means of coordinating globally dispersed units within the MNC (Gates & Egelhoff, 1986), aligning subsidiary behavior with corporate objectives (O'Donnell, 2000), and mitigating uncertainty in culturally distant locations (Garnier, 1982). However, there are still significant theoretical and empirical gaps in our understanding of the complex inter-relationship between the parent firm's choice of ownership mode and the extent of its strategic control over a subsidiary. More specifically, little is known about how this inter-relationship is affected by cultural distance between the parent firm and its subsidiary.

Previous research has extensively investigated the level of control that different ownership modes provide the parent firm over their foreign subsidiaries (Anderson & Gatignon, 1986, Kim & Hwang, 1992, Padmanabhan & Cho, 1996). Most of these studies directly associate the ownership mode with the actual extent of control (Anderson & Gatignon, 1986, Kim & Hwang, 1992). However, research on "subsidiary mandate" clearly indicates that even within the same type of ownership modes parent firms may have varying levels of control over foreign subsidiaries, depending, for example, on their contribution of firm-specific assets (Birkinshaw, Hood, & Jonsson, 1998) or the type of mandate they develop within the global MNC network (Birkinshaw & Morrison, 1995). These scholars identify determinants of operational control (or autonomy) in foreign subsidiaries and acknowledge that subsidiaries differ in terms of their extent of strategic control; however, they do not take the type of ownership mode into account.

We build on this research and distinguish between ownership mode and extent of strategic control. By grounding our study within the multiple agency theory (Arthurs, Hoskisson, Busenitz, & Johnson, 2008, Bruton, Filatotchev, Chahine, & Wright, 2010), we argue that ownership mode and extent of strategic control are not equivalent, as the ownership mode only determines the contractual relation between the parent firm and the foreign subsidiary (i.e. the potential structure of a decision-making hierarchy), but not the actual extent of control parent firms exercise over the decision-making process in their subsidiaries. This assumption is in line with existing research that argues that control “is a much more subtle phenomenon [...] and it can be quite distinct from mere consideration of relative equity ownership” (Geringer & Hebert, 1989: 240-241). In a similar vein, Filatotchev and Wright (2011: 478) contend that “dominant ownership may not bring control in certain host country environments and minority equity holders may have effective control of certain activities within an IJV.” Surprisingly, empirical evidence on this important relationship is still lacking.

In addition, we investigate whether the relationship between the ownership mode and the extent of strategic control over foreign subsidiaries is dependent on the contextual environment. We take into account cultural distance between the parent firm and foreign subsidiary, suggesting that cultural distance is a source of uncertainty that affects the relationship between the type of ownership mode and the extent of strategic control. Cultural distance has gained a considerable prominence in the international business (IB) literature. Cho and Padmanabhan (2005: 309) state, for instance, that “almost [...] no international business study can be complete unless there is an explicit variable controlling for cultural distance.” The vast majority of studies are focused on links between cultural distance and the choice of ownership mode, although with inconclusive results (for a review, see Harzing, 2003, Shenkar, 2001). In general, cultural distance has been viewed as a determinant of uncertainty given that it complicates the verification of claims of subsidiary managers. More importantly, previous studies use cultural distance either as a proxy for the cost of internalization (internal uncertainty) or information costs (external uncertainty). There is a paucity of studies that recognized that cultural distance increases both the cost of internalization and

information costs (Slangen & van Tulder, 2009). By building on research by Vaccani (1999), among others, we make a further theoretical advance by arguing that cultural distance may affect the level of strategic control parent firms impose on their subsidiaries in host markets. More specifically, we develop theoretical arguments and provide empirical tests that show that cultural distance moderates the relationship between the ownership mode and the extent of strategic control over the subsidiary: the extent of control over WoS (IJVs) declines (increases) when cultural distance increases.

We focus on foreign subsidiaries in the People's Republic of China (PRC). With more than US \$95 billion in inward FDI in 2009 (UNCTAD, 2011) the country is one of the largest recipients of FDI globally. Moreover, according to the statistics of MOFCOM (2010) wholly-owned subsidiaries (WoS) and international joint ventures (IJVs) are the dominant ownership modes in China. Therefore, we focus on these two types of ownership modes in our analysis. Given that FDI in China involves investors from countries exhibiting high variation in cultural distance to China, we believe that this country provides a valuable setting for analyzing the moderating effect of cultural distance.

We make a number of theoretical contributions to the literature. First, we build on multiple agency research and show that the extent of strategic control exerted over foreign subsidiaries can substantially differ from the ownership mode, i.e. the level of internalization within the Williamson's (Williamson, 1973) market-hierarchy continuum. Second, we argue that cultural distance increases the level of uncertainty and thus the agency problems between the parent firm and the foreign subsidiary, moderating the relationship between ownership mode choice and actual extent of strategic control. In this respect, we view cultural distance as a source of both external and internal uncertainty and argue that ownership mode choices are associated with different types of uncertainty. Finally, while most research has analyzed subsidiaries in developed countries (Cleeve, 1997, Hennart, 1991, Kogut & Singh, 1988), we conduct our analysis in an emerging market. Overall, our results may challenge existing reasoning related to the relationship between ownership mode and control as well as the moderating role of cultural distance.

The remainder of this paper is organized as follows. In the next section, we present our theoretical framework and conceptualize our main theoretical constructs. In the following section, we derive hypothesis about the effect of ownership mode choice on the actual extent of strategic control. This is followed by arguments related to the moderating effect of cultural distance. The ensuing section presents our sample and measures followed by a discussion of our empirical results. The final section outlines implications and limitations of our research.

## **THEORETICAL FRAMEWORK AND CONCEPTUALIZATION**

Filatotchev and Wright (2011) argue that issues related to strategic controls in IB have a strong behavioral dimension, and this is a focal point of agency-grounded research. Following research by Chang and Taylor (1999), O'Donnell (2000), Johnson et al. (2001), and Roth and O'Donnell (1996), among others, we build on agency theory to describe the relationship between the parent firm and the foreign subsidiary management. For the purpose of our study, the parent firm represents the principal, while the management of the foreign subsidiary represents the agent. Therefore, a potential agency conflict is associated with goal incongruence between the parent firm and subsidiary management, especially when it is difficult for the parent firm to monitor the subsidiary's actions (O'Donnell, 2000). For example, Chang and Taylor (1999) argue that the headquarters-subsidiary relationships can be explained in terms of agency theory because the parent firm expects the subsidiary management to work on its behalf in return for the resources and competences it transfers abroad. In a similar vein, Roth and O'Donnell (1996: 680) suggest that headquarters-subsidiary relationships fit well agency framework as "headquarters delegates work and responsibilities to foreign subsidiaries."

In agency theory, the ownership mode of foreign subsidiaries determines the contractual relation between the parent firm (i.e. the principal) and the foreign subsidiary (i.e. the agent) (Yan & Gray, 2001). Moreover, this choice defines the potential extent of managerial hierarchy and associated cash-flow rights of investors in a foreign subsidiary. We focus on two typical types of ownership modes in foreign markets: IJVs and WoS. In addition, the actual extent of control parent firms exert over the foreign

subsidiary management is another key dimension of governance given that control serves as a means of solving agency problems. Therefore, the extent of control parent firms exert over foreign subsidiaries is a means of aligning subsidiary behavior with parent firm's corporate objectives (O'Donnell, 2000). We focus on the extent of strategic control and define it in line with Geringer and Hebert (1989: 241) as the extent of decision-making that actually takes place at the parent firm in areas such as strategic decisions, R&D, production, distribution, budget responsibility, and adjustment to local requirements.

Within agency research, uncertainty surrounding the decision-making process is considered a key driver of potential agency conflicts. According to past research, this uncertainty is substantially influenced by cultural distance (Roth & O'Donnell, 1996), and, therefore, cultural distance may be a source of potential and actual agency problems. Specifically, we suggest that cultural distance is a source of uncertainty since it complicates the verification of claims of subsidiary agents. Roth and O'Donnell (1996), for instance, used cultural distance in the context of headquarters-subsidiary relationships and reported that cultural distance aggravates agency problems as it increases information asymmetry between the parent firm and the foreign subsidiary. We define cultural distance in line with past research as the differences in social norms and values between the home and the host country (Hofstede, 1980) and conceptualize it as a moderator in the relationship between ownership mode choice and actual extent of strategic control.

Finally, we clearly distinguish between external and internal uncertainty and suggest that cultural distance is a source of both types of uncertainty since it complicates the verification of claims of both external and internal agents. Slangen and van Tulder (2009), for instance, argue that cultural distance is both a determinant for external and internal uncertainty, and Lee et al. (2008: 1117) emphasize that scholars have insufficiently differentiated between the "challenge of working in a foreign environment" (external uncertainty) and the "challenge of working with a foreign partner" (internal uncertainty). Therefore, cultural distance should have a significant impact on the extent of actual or anticipated agency conflicts between parent firms and their subsidiaries in different countries, and this should have a



profound impact on the extent of strategic control parent firms exercise over their subsidiaries. In the following sections, we develop these arguments further and suggest testable hypotheses.

## **HYPOTHESES DEVELOPMENT**

### **Ownership Mode and Extent of Strategic Control**

Within agency framework, an ownership mode associated with a foreign subsidiary defines the contractual relationship between the parent firm (i.e. the principal) and the foreign subsidiary (i.e. the agent) (Yan & Gray, 2001). While WoS represent unilateral contracts with a clear principal-agent relationship, IJVs represent relational contracts with multiple principles and agents. We focus on these two types of ownership modes in foreign markets and argue that the different contractual arrangements underlying these modes have different implications for the level of agency costs and, as a result, for the extent of strategic controls a parent would want to engage to minimize these costs.

The complexity of the contractual relationship and associated agency conflicts considerably differ between these two ownership modes, with the complexity of the relationship between parent firms and IJVs being higher than between parent firms and WoS. IJVs represent contractual relations in which two or more parent firms share ownership and control rights over the combined resources to achieve goals they cannot achieve on their own. WoS, on the other hand, represent unilateral contracts that grant the parent firm ownership and associated residual claim rights over the foreign subsidiary's assets and profits (Puck, Holtbrügge, & Mohr, 2009). Yan and Gray (2001: 303) refer to an IJV as "incomplete contract in which the partners have to live with substantial uncertainties down the road." These factors suggest that WoS and IJVs may suffer from different types of agency conflicts. WoS represent a classic case of a parent firm needing to monitor and restrain managerial opportunism on the subsidiary level. IJVs may suffer from what more recent research describes as a "multiple agency" conflict (Arthurs, Hoskisson, Busenitz, & Johnson, 2008, Bruton, Filatotchev, Chahine, & Wright, 2010). Managers in an IJV are agents to multiple principals in a venture (e.g., foreign and local co-investors). These multiple principals may have different

goals and objectives, diverse decision-making horizons, and strategic priorities. As a result, a dichotomous principle-agent conflict described by mainstream agency research does not apply in the context of IJVs where managers have to reconcile the objectives of multiple principals.

Building on this research, we suggest that the shared arrangement in IJVs and, in particular, the idiosyncratic commitment of resources, complicate the ability of parent firms to observe and evaluate how these resources are deployed in foreign markets compared to the arrangements in WoS (Johnson, Cullen, Sakano, & Bronson, 2001). Parent firms operating IJVs thus often find it more difficult to assess whether the competences and resources transferred abroad yield their highest productive value compared to their counterparts operating WoS. Reuer and Miller (1997: 426) argue, for instance, that in IJVs agency hazards may occur “due to coordination problems arising from shared ownership and control”. In WoS, by contrast, the direct, unilateral chain of command facilitates the monitoring of deployed resources and competences. Therefore, from a multiple agency theory perspective, we expect that the joint management of foreign operations increases the level of agency costs for parent firms, leading to a higher agency costs for firms operating IJVs than for their counterparts operating WoS.

In addition, involvement of a third party in IJVs increases the ambiguity surrounding the actions and behavior of subsidiary management abroad compared to WoS, further aggravating problems associated with information asymmetry. For parent firms, it often becomes difficult to process information from IJV management and subsequently devise and implement corporate strategies. Furthermore, ambiguity stemming from third-party involvement complicates the ability of firms to align subsidiary managers' actions and behavior with corporate objectives. In IJVs, this increase in information asymmetry may provide scope for managerial opportunism and suboptimal strategic decision-making (Johnson, Cullen, Sakano, & Bronson, 2001). This ambiguity may enhance the likelihood of goal incongruence and managerial conflicts more substantially in IJVs than in WoS given that the integration of diverse management approaches may hamper IJV operations. In WoS, in contrast, the transfer and implementation of management practices are less difficult and costly given the increased possibilities of directly

supervising and commanding subsidiary management. From an agency theory perspective, this ambiguity increases the information deficit for parent firms, leading to a higher information asymmetry and agency costs between parent firms and IJVs than between parent firms and WoS. Ott (2005: 67) contends that “the triangular structure” in IJVs contributes to an information problem. Overall, we contend that the complexity of the contractual relationship and ambiguity of subsidiary managers’ actions and behavior (that stem from the joint management of foreign operations) entail higher agency costs for parent firms operating IJVs than for their counterparts operating WoS.

Agency theory suggests that in order to reduce agency costs, parent firms may use strategic controls over the decision-making process in a subsidiary (Johnson, Cullen, Sakano, & Bronson, 2001). Eisenhardt (1989: 63), for instance, maintains that agency theory is about “the optimal structuring of control relationships” to manage complexity, which arises from the difficulties in verifying the claims from subsidiary agents. Consequently, the extent of strategic control parent firms exert over the foreign subsidiary is a means of reducing the complexity and ambiguity inherent in contractual relationships as well as aligning subsidiary managers’ behavior with parent firm’s corporate objectives (O’Donnell, 2000). When agency conflicts are significant, a greater extent of strategic control may increase the efficiency of parent firm – subsidiary relationships. Specifically, greater extents of control may serve as an effective means of curbing managerial opportunism and limiting the potential for irrational strategic decision-making on the subsidiary level (Johnson, Cullen, Sakano, & Bronson, 2001). Moreover, higher control is expected to improve the transfer and implementation of management practices in complex relationships. In this context, parent firms seek to limit self-serving behavior of managers by exerting higher extents of control over strategic decisions such as adjustment to local requirements as well as over the subsidiary’s value chain.

Given that we argue that the agency problem is more significant in IJVs than in WoS, we expect that parent firms increase their extent of control more strongly over IJVs than WoS, suggesting that there may not be one-to-one correspondence between ownership mode choice and the extent of strategic control

exerted over foreign subsidiaries. Johnson et al. (2001: 37) argue that “agency theory suggests that parents intervene in IJV decision-making and operations to ensure that the IJV (i.e., the agent) is serving the principal's (the parent firm's) agenda.” Moreover, Yan and Gray (2001) argue that the use of control may reduce the level of agency costs in IJVs resulting from the potential managerial opportunism. Building on these arguments we suggest:

**Hypothesis 1:** The extent of strategic control used by a parent firm in its foreign subsidiary is higher in IJVs than in WoS.

### **The Moderating Effect of Cultural Distance**

In the previous section, we argued that the nature and the extent of agency problems in WoS and IJVs are different, and these ownership modes may be associated with different degrees of the parent’s strategic controls used as a solution of actual or potential agency conflicts. We extend these arguments further and suggest that cultural distance is a source of uncertainty that further aggravates agency problems by enhancing information asymmetries between the parent firm and the subsidiary (Roth & O'Donnell, 1996). Specifically, we view cultural distance as a source of both external and internal uncertainty since it complicates the verification of claims of both external *and* internal agents. However, previous studies indicate that ownership modes are associated with different levels of external and internal uncertainties related to cultural distance (Slangen & van Tulder, 2009).

Prior research suggests that WoS are associated with higher external uncertainty stemming from cultural distance than IJVs (Anderson & Gatignon, 1986, Brouthers & Brouthers, 2001, Gatignon & Anderson, 1988, Root, 1987, Slangen & van Tulder, 2009). With high cultural distance, WoS are embedded in an external environment which substantially differs in terms of social norms and values from home country of the parent firm. These different norms and values entail differences in behaviors, attitudes, cognition, and interpretation and they may complicate social interactions with local stakeholders in the host country (e.g., local buyers, suppliers, government bodies etc.). Specifically, with growing cultural distance, parent firms lack social knowledge to interpret behavior of local stakeholders and thus

may face considerable obstacles in predicting their social patterns (Sohn, 1994). Scholars emphasize that this understanding of the host culture cannot be acquired in advance because of its tacit nature (Yamin & Golesorkhi, 2010). Therefore, we suggest that the parent firms' lack of social knowledge in culturally distant locations makes it difficult to verify claims from stakeholders, increasing the level of external uncertainty associated with WoS.

In contrast, IJVs are associated with lower external uncertainty resulting from cultural distance than WoS (Agarwal, 1994, Gatignon & Anderson, 1988, Kogut & Singh, 1988). The reason is that the local partner in an IJV can provide tacit knowledge about the host country's social norms and values and, in particular, about the behavior patterns of local stakeholders (Slangen & van Tulder, 2009). Hence, the local IJV partner can assist the parent firm in dealing with culturally distant stakeholders, which may alleviate information requirements and facilitate the verification of claims in the stakeholder network (Agarwal, 1994, Barkema & Vermeulen, 1997, Gatignon & Anderson, 1988). Therefore, we argue that the "social knowledge" (Sohn, 1994) contributed by the IJV partner reduces information requirements and mitigates the level of external uncertainty. Lu and Hébert (2005: 738) suggest that "forming an IJV permits foreign investors to access complementary assets and to reduce accordingly the [external] uncertainty they are confronting." Similarly, Gatignon and Anderson (1988: 307) regard IJVs as a means of "bridging cultural gaps." Thus, past research suggests that IJVs are vehicles that provide access to tacit knowledge about the host culture and the behavior patterns of local stakeholders, reducing the level of external uncertainty.

Internal uncertainty refers to the operations of the foreign subsidiary (Lu & Hébert, 2005). Given different contractual relations, IJVs may be associated with higher levels of internal uncertainty than WoS. Following prior research (Barkema & Vermeulen, 1997, Hennart & Zeng, 2002), we thus argue that cultural distance is a key determinant of internal uncertainty in IJVs since these hybrid modes are – in contrast to WoS – jointly managed by firms from dissimilar cultures (Luo, Shenkar, & Nyaw, 2001). Specifically, the integration of these dissimilar cultures may involve combining different value systems,

management styles, and organizational structures (Hennart & Zeng, 2002, Kogut & Singh, 1988), all of which may lead to divergent goals and potential conflicts in the course of IJV operations. Slangen and van Tulder (2009) stress that cultural differences between IJV partners may nurture goal incongruence and managerial conflicts. Yan and Gray (2001: 304) maintain that “the agency problem in IJVs is rooted in the divergent self-interests of the parents and their objectives for the venture’s operation”, which is especially the case when cultural distance is high. Therefore, with growing cultural distance, IJVs are exposed to higher levels of internal uncertainty as cultural distance may increase the likelihood of goal incongruence and managerial conflicts, and subsequently complicate the verification of claims in IJV operations (Gatignon & Anderson, 1988, Gaur & Lu, 2007, Meschi & Riccio, 2008).

WoS are considerably less affected by internal uncertainty. Prior research contends that the uncertainty resulting from goal incongruence and managerial conflicts is lower in WoS due to the clear distribution of ownership rights (Chang & Taylor, 1999, Geringer & Hebert, 1989, Hedlund, 1981, Luo, Shenkar, & Nyaw, 2001). These rights facilitate the verification of claims in WoS (Slangen & van Tulder, 2009, Tsang, 1994). In sum, we argue that WoS are associated with higher external uncertainty stemming from cultural distance than IJVs. By contrast, IJVs are associated with higher levels of internal uncertainty than WoS.

In order to reduce the high levels of external uncertainty resulting from cultural distance in WoS past research suggests that parent firms need to leave decision-making to their foreign subsidiaries (Garnier, 1982). The higher the cultural distance, the more flexibly and rapidly the WoS needs to respond to this unfamiliar environment to adjust to cultural peculiarities and verify claims from local stakeholders in the host country. From the agency theory perspective, parent firms are thus expected to reduce the extent of strategic control over WoS given that it may be easier to evaluate outcomes than control activities in the value chain in an environment of external uncertainty. Lee et al. (2008: 1118) argue, for instance, that parent firms relinquish control “as a way to alleviate problems in culturally distant locations”, which echoes some previous studies (Agarwal, 1994, Kogut & Singh, 1988, Shenkar, 2001).

Moreover, Hedlund (1981) assumes that parent firms reduce the extent of control in order to mitigate external uncertainty and information requirements resulting from cultural distance. Therefore, parent firms can reduce the level of external uncertainty in culturally distant operations by reducing the extent of strategic control over their WoS.

In contrast, previous research suggests that, to manage the high internal uncertainty in IJVs, parent firms need to increase the extent of strategic control in foreign subsidiaries (Chang & Taylor, 1999, Geringer & Hebert, 1989, Hedlund, 1981, Luo, Shenkar, & Nyaw, 2001). Control is considered as a means of reducing the likelihood of goal incongruence and managerial conflicts, which ultimately facilitates the verification of claims in the course of IJV operations. Johnson et al. (2001: 38) contend that the cultural distance between joint venture partners influences “the entire joint venture dynamic” entailing consequences for parent firm’s extent of control over the venture. Moreover, Luo et al. (2001) argue that parent firms should seek control in case of high cultural distance and goal incongruence. Geringer and Hebert (1989: 244) argue that “control is a mechanism for reducing the risks associated with coordination, potential conflicts and [...] consequently, for minimizing transaction costs.” Moreover, Chang and Taylor (1999) report that high internal uncertainty increases the MNC’s reliance on control given that control curbs the potential of undesirable behavior and actions. Finally, Hedlund (1981) suggests that parent firms enhance the extent of control over their foreign subsidiaries to mitigate high levels of internal uncertainty stemming from cultural distance and ultimately increase efficiency. Taken together, parent firms can reduce the level of internal uncertainty in IJVs by enhancing their extent of control.

Overall, we argue that the interplay of external and internal uncertainties associated with cultural distance ultimately influence the extent of strategic control parent firms exert over their foreign subsidiaries. Given that WoS are associated with high external uncertainty but low internal uncertainty parent firms are expected to increase the extent of strategic control more strongly in IJVs than in WoS with increasing cultural distance. Hence, we suggest the following hypothesis:

**Hypothesis 2:** The relationship between the choice of ownership mode and the extent of strategic control is moderated by the level of cultural distance. The higher the cultural distance, the lower the extent of the parent firm's strategic control over WoS and the higher the extent of strategic control over IJVs.

## RESEARCH DESIGN AND METHODOLOGY

### Data and Sample

To examine the influence of cultural distance on the extent of strategic control, we have collected primary data from foreign companies located in the PRC through a questionnaire survey. We focused on foreign firms headquartered in the United States, Japan, and Europe, while deliberately excluding investors from Hong Kong, Taiwan, Macao, Singapore, Malaysia, as well as offshore financial centers such as the Virgin Islands or Western Samoa. These countries were excluded to eliminate round-tripping investments (Xiao, 2004) and investments from overseas Chinese companies, which are not directly comparable with investments from other foreign investors. In order to compile a comprehensive database of contact addresses we contacted national chambers of foreign trade of Japan, the United States, the UK, Germany and the European Union. Furthermore, we analyzed company home pages and articles in newspapers such as *China Business Review*. In total, we identified contact details of 1,979 IJVs and WoS of foreign companies in the PRC. The original German language questionnaire was translated into English, Japanese, French, and Spanish by three professional translators. We used the translate/back-translate method to ensure the equivalency of the questionnaires (Brislin, 1970). The questionnaire was distributed via e-mail accompanied by an executive summary explaining the objective of the study. Those companies that had not replied by the original deadline received a reminder two weeks later. After a second deadline, we have received 195 questionnaires (response rate of 9.9 percent). Due to missing information, unclear ownership of the subsidiary or recent ownership changes towards a financial investor from an offshore location, data analysis was based on 156 cases. The relatively low response rate may in part be explained by the questionnaire fatigue reported by many managers of subsidiaries of foreign firms in the PRC (one respondent who declined to participate in the study explained that he would receive more than seven



questionnaires per week). Sampled subsidiaries were established by companies headquartered in 14 countries, with the United States, Germany, Japan and the UK accounting for the majority of investments. The majority of the respondents (82%) were general managers of the respective subsidiary, 7% were subsidiary CFOs, and 6% marketing managers.

We assessed non-response bias by using approach developed by Armstrong and Overton (1977). A comparison of early- and late-arriving responses by means of logistic regression indicated that the likelihood of a non-response bias for our study variables was low (all  $ps > 0.10$ ). Consequently, non-response bias was not considered to be a problem. Since our dependent variable was constructed using primary data, our independent variable is derived from secondary sources, and our moderator is a dichotomous yes/no variable, common method bias can only exist at the level of control variables. To minimize common method bias, we followed the strategies suggested by Podsakoff et al. (2003). In particular, we separated items measuring the same construct in the questionnaire, protected and assured respondent anonymity, and reduced the danger of evaluation apprehension by explaining in the executive summary that there were neither “right” nor “wrong” answers.

### **Operationalization of Variables**

*Dependent variable.* To measure the extent of strategic control we combined suggestions of Birkinshaw et al. (1998), Hill (1988), and Vachani (1999). Managers were asked to evaluate the extent of control on the following six dimensions: strategic decisions, research and development, organization of production, organization of distribution, budget responsibility and adjustment to local requirements. Moreover, following Dang (1977) we conceptualized control as an inverse measure of subsidiary autonomy. Answers to these questions were measured on seven-point Likert-type scales ranging from 1 (the subsidiary’s autonomy is very low) to 7 (the subsidiary’s autonomy is very high). To examine whether these items formed a single construct, we used confirmatory factor analysis (CFA). A one factor model did not fit the data well ( $\text{Chi}^2(9) = 31.71$ ;  $\text{RMSEA} = 0.13$ ;  $\text{CFI} = 0.93$ ;  $\text{SRMR} = 0.07$ ). As lack of fit was predominantly due to a single item (research and development), we excluded this item. A one factor model for the

remaining five items exhibited good fit ( $\text{Chi}^2(5) = 6.85$ ;  $\text{RMSEA} = 0.05$ ;  $\text{CFI} = 1.00$ ;  $\text{SRMR} = 0.03$ ). We thus averaged responses to these five items to form a composite index, which showed good internal consistency (Cronbach's alpha = 0.78).<sup>1</sup>

*Independent variable.* The ownership mode of the subsidiary was measured using a dichotomous variable, assigned 0 if the subsidiary operated as an IJV and 1 if the subsidiary was a WoS (Brouthers, Brouthers, & Werner, 2003, Hennart & Larimo, 1998, Padmanabhan & Cho, 1996). IJVs were defined according to Chinese regulations that use the 30/70% cut-off point to classify IJVs. In our sample, we only included sino-foreign ventures, but no foreign-foreign or sino-sino ventures.

*Moderating variable.* Cultural distance between the home and the host country was measured using the index of Kogut and Singh (1988). They suggest employing the results of Hofstede's (2001, 1980) study to calculate a single composite index of cultural distance for each country pair using the following formula:

$$CD_{jk} = \sum \sum \frac{(D_{ij} - D_{ik})^2}{V_i} / 4$$

where  $CD_{jk}$  reflects the cultural distance between country  $j$  and China ( $k$ ),  $D_{ij}$  reflects the value of country  $j$  and  $D_{ik}$  the value of China on the cultural dimension  $i$ , and  $V_i$  indicates the variance of the cultural dimension index  $i$  based on Hofstede (2001, 1980). However, Hofstede's work has also been subject to criticism. For instance, some authors have indicated that his four dimensions of culture are not exhaustive because the study was not initially geared towards identifying dimensions along which countries differ. Moreover, critics have complained that his data were confined to one company, that his questions focused exclusively on work values, and that his research framework was biased towards Western standards (for a

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<sup>1</sup> Calculating factor scores using regression analyses may be used as an alternative. Yet, Grice (2001) notes that averages can be considered a specific type of factor score (using unit weights instead of a weight matrix derived mathematically) and they typically yield highly similar and robust results. A robustness test, we calculated factor scores using the Anderson-Rubin Method implemented in LISREL 8.80. These scores were highly correlated with our simple averages (i.e.,  $.89 > r < 1.00$ ). We also re-estimated the regression analyses using factor scores for the multi-item measures, and we have obtained very similar results (not reported here due to length constraints).

review, see Drogendijk & Slangen, 2006, Erez & Early, 1993, Javidan, House, Dorfman, Hanges, & Luque, 2006).

Despite these concerns, Hofstede's (2001, 1980) metrics continue to be widely applied in IB research (Magnusson, Wilson, Zdravkovic, Joyce Xin, & Westjohn, 2008), and Hofstede's distance dimensions have been empirically validated in numerous studies (for a review, see Sondergaard, 1994). Kim and Gray (2009), for instance, provided empirical evidence that Hofstede's metrics outperformed GLOBE (House, Hanges, Javidan, Dorfman, & Gupta, 2004) in explaining governance choices in Korea. Furthermore, Drogendijk and Slangen (2006) found that Hofstede's measures of cultural distance outperformed the explanatory power of managerial perceptions in explaining establishment mode choices by parent firms. Overall, these findings indicate that Kogut and Singh's (1988) index is a reliable and valid measure reflecting important cultural differences in IB.

In addition, we assume that informal differences in cultural distance have a stronger effect on the relationship between ownership mode and extent of control than formal differences such as economic and political distance. Differences in the economic environment are usually observable for foreign subsidiaries and may even be negligible in the more "developed" regions in the PRC. Furthermore, economic differences are all rooted within a capitalist system. Even though this system might work slightly different in China, the basic rules remain the same. Thus, economic distance may neither contribute strongly to external nor internal uncertainty and therefore hardly enhances the level of agency costs. While political systems may differ substantially (as it is the case in China compared to free-market political systems), the rules of the system are relatively easy to observe, and written rules (e.g., constitution, laws) can be understood by everyone (Scott, 1995). Thus, political distance has a differential impact on external and internal uncertainty, but not to a high extent. Finally, cultural differences are deeply embedded in social norms, beliefs and values. Many aspects of culture can hardly be codified or directly observed (Yiu & Makino, 2002). Therefore, foreign subsidiaries may find it easier to learn about and adapt to differing political and economic conditions than to cultural differences. In a similar vein, Gaur and Lu (2007) note

that foreign subsidiaries can easily obtain information about formal, political differences by drawing on secondary information. They report further that cultural differences are rooted in the social environment and are thus harder to grasp and interpret by the foreigners (Demirbag, Glaister, & Tatoglu, 2007). From the agency perspective, cultural distance may therefore have the strongest effect on external and internal uncertainty and, as a result, it contributes more substantially to the level of agency costs than political and economic distances.

*Control variables.* Ten control variables were included in the analysis (Becker, 2005). We included the competitive pressure in the industrial sector given that a highly competitive environment influences the level of external uncertainty and information costs, prompting parent firms to reduce the extent of control over their foreign subsidiaries (Gates & Egelhoff, 1986, Hedlund, 1981). To assess competitive pressure, we used a four-item measure suggested by Kim and Hwang (1992). We asked managers to evaluate the degree of instability of their market share, the number of existing and potential competitors, the level of fixed costs relative to value added, and the costs facing the buyer when switching suppliers. Answers to these questions were measured on seven-point Likert-type scales. As CFA showed satisfactory fit for a single factor model ( $\text{Chi}^2(2) = 10.51$ ;  $\text{RMSEA} = .08$ ;  $\text{CFI} = .92$ ;  $\text{SRMR} = 0.01$ ), we use the average of these items in our analyses ( $\alpha = 0.89$ ).

We also used resource sharing as a control variable as research has suggested that high levels of resource sharing between the parent firm and the foreign subsidiary leads to higher extents of control (Andersson & Forsgren, 1996, Birkinshaw & Morrison, 1995). We followed the suggestions of Davis et al. (2000) and operationalized it with a five-item measure. We asked managers to evaluate resource sharing between the parent firm and the subsidiary in the following activities of the value chain: research and development, raw materials, plant and equipment, advertising and promotional efforts and personnel, and a common sales force. Answers to these questions were measured on seven-point Likert-type scales ranging from 1 (very low) to 7 (very high). A CFA of these items showed that a single factor model did not fit well ( $\text{Chi}^2(5) = 42.07$ ;  $\text{RMSEA} = 0.23$ ;  $\text{CFI} = 0.81$ ). This was mostly due to the item assessing

advertising and promotional efforts and excluding this item yielded a single factor model that fit the data well ( $\text{Chi}^2 (2) = 3.46$ ;  $\text{RMSEA} = 0.07$ ;  $\text{CFI} = 0.99$ ;  $\text{SRMR} = 0.04$ ). We averaged these four items to obtain a measure of resource sharing ( $\alpha = 0.68$ ).

To account for a foreign subsidiary's firm-specific assets, we included the degree of asset specificity. Asset specificity is assumed to increase the level of internal uncertainty since it induces partners to behave opportunistically and exploit unilateral dependencies. In order to curb opportunism and protect firm-specific assets scholars have suggested that parent firms enhance the extent of control over their foreign subsidiaries (Geringer & Hebert, 1989, Mjoen & Tallman, 1997, Yan & Gray, 2001). The degree of asset specificity was assessed using three items developed by Brouthers and Brouthers (2003). Managers rated the level of human asset specificity, the proprietary nature of products/services provided, and the amount of assets that would have been forgone outside the specific transaction. Again, seven-point Likert-type scales were used, and a CFA showed satisfactory for a single factor model ( $\text{Chi}^2 (1) = 9.58$ ;  $\text{RMSEA} = 0.08$ ;  $\text{CFI} = 0.91$ ;  $\text{SRMR} = 0.01$ ). We used the average score of these items in our analyses ( $\alpha = 0.78$ ).

In addition, following previous research (Birkinshaw, Hood, & Jonsson, 1998, Edwards, Ahmad, & Moss, 2002) we used knowledge development as control variable. Respondents were asked to rate China-specific knowledge available in their company at a market entry on the following five dimensions: market knowledge, knowledge about the regulatory framework, the economic conditions, the political situation and the Chinese business culture. Answers to these questions were measured on seven-point Likert-type scales ranging from 1 (the level of knowledge is/was much lower than at the time we entered the market) to 7 (the level of local knowledge is/was much higher than at the time we entered this market). As responses to these questions were combined to form a composite index, with a single factor CFA model showing adequate fit ( $\text{Chi}^2 (5) = 6.32$ ;  $\text{RMSEA} = 0.05$ ;  $\text{CFI} = 1.00$ ;  $\text{SRMR} = 0.03$ ), we averaged these items to obtain a measure of knowledge development. The internal consistency of the construct as measured by Cronbach's alpha was high (0.85).

We also control for industry sector on the basis of SIC codes as previous studies have suggested that parental control differs by industry (Makhija, Kim, & Williamson, 1997). We used the 10 category division coding system as our sample included a host of sparsely populated two-digit major industry codes. The companies came from 7 out of 10 divisions, that is, our sample did not contain companies from public mining (Division B), construction (Division C), and public administration (Division J). In our regression analyses, we used six dummy variables to contrast manufacturing (Division D) with other divisions.

We included several single item measures. These were the age of the subsidiary since previous studies have suggested that with increasing age parent firms reduce the extent of control over foreign subsidiaries (Chang & Taylor, 1999, Garnier, 1982, Gates & Egelhoff, 1986, Harzing, 1999, Taggart & Hood, 1999, Van den Bulcke & Halsberghe, 1984). We used the length of time in years that had passed since the establishment of the subsidiary in the PRC as a measure for subsidiary age (Hennart, 1991).

We included the type of subsidiary as a control variable given that prior research suggested that the competencies of the subsidiary level influence parental control (Taggart & Hood, 1999, Young, Hood, & Hamill, 1985). We measured type of subsidiary using a dichotomous variable, assigned 0 if the subsidiary is involved in full operations and 1 if the subsidiary only performs sales and service activities.

Prior research indicated that responsiveness to local market needs may prompt parent firms to reduce control (Martinez & Jarillo, 1991, Roth & Morrison, 1992). To control for this effect, we used a dichotomous variable, assigned 0 if the type of product manufactured/service provided by the subsidiary is the same as the parent firm, and 1 if the type of product manufactured/service provided is different from the parent firm (Chang & Rosenzweig, 2001, Kogut & Singh, 1988).

Finally, we included the China-specific experience as control variable since prior research suggested that experience affects control over subsidiaries (Harzing, 1999, Taggart & Hood, 1999). We operationalized it as the number of subsidiaries an MNC had in the PRC.

## RESULTS

Table 1 shows the means, standard deviations, and bivariate Pearson correlations. In our sample, 60% of the subsidiaries were WoS and the mean age of the subsidiaries was 8.5 years ( $SD = 5.80$ ). In line with our expectations, the ownership mode variable is negatively and strongly significantly correlated with the strategic control variable, but it is not correlated with cultural distance.

===== INSERT TABLE 1 ABOUT HERE =====

We employed hierarchical multiple regression (Aguinis, 1995) to test our hypothesis. To simplify the interpretation of interaction effects, we standardized and thereby centered cultural distance prior to the analyses. Results of regression analyses for three models are depicted in Table 2. Model 1 contains control variables only. In Model 2, the main effects of ownership mode and cultural distance are added. The type of ownership mode has a significant negative effect on the extent of strategic control, indicating that WoS experience lower levels of control than IJVs. Thus, hypothesis 1 is supported. In Model 3, we entered the interaction term of ownership mode and cultural distance as a test of hypothesis 2. Entering the interaction term improved model fit significantly ( $\Delta R^2 = 0.04$ ;  $p < 0.01$ ). Moreover, the coefficient of the interaction term is significant ( $-0.54$ ;  $p < 0.01$ ), confirming hypothesis 2 that cultural distance moderates the relationship between the type of ownership mode and the extent of strategic control. Thus, the relationship between cultural distance and extent of strategic control is negative for WoS and positive for IJVs. While IJVs and WoS do not differ in terms of extent of strategic control when cultural distance is low, parent firms increase the extent of control in IJVs and reduce it in WoS with increasing cultural distance. Therefore, hypothesis 2 also receives support.

===== INSERT TABLE 2 ABOUT HERE =====

In terms of controls, knowledge development significantly reduced the extent of control over foreign subsidiaries. This result is in line with previous studies, which corroborated that highly knowledgeable subsidiaries enjoy greater levels of autonomy (Edwards, Ahmad, & Moss, 2002). The age

of the subsidiary had a significant positive effect on the extent of control, even though one would expect otherwise. However, some studies also support this finding (Chang & Taylor, 1999, Hedlund, 1981, Young, Hood, & Hamill, 1985), and an explanation for this result may be that in high growth markets such as China, parent firms prefer to retain a high extent of control to exploit economies of scale even after several years of operations (Agarwal & Ramaswami, 1992, Brouthers, 2002).

The competitive pressure in the industrial sector has been argued to influence the level of external uncertainty and information costs, inducing parent firms to reduce the extent of control over their foreign subsidiaries (Gates & Egelhoff, 1986, Hedlund, 1981). However, in contrast to the suggestions of previous studies (Birnbaum & Wong, 1985, Wong & Birnbaum-More, 1994) we did not find a significant effect for this variable. This finding may be explained by the fact that some parent firms that have been operating in the PRC for some time have developed ways of dealing with high competition that do not affect the extent of control over the subsidiary.

In addition, the degree of asset specificity, which has been suggested by scholars (Geringer & Hebert, 1989, Mjoen & Tallman, 1997, Yan & Gray, 2001) to lead to higher extents of control was insignificant. A possible explanation for this lack of significance may be the high degree of product piracy and persistent lack of protection of (intellectual) property rights in China (Puck, Holtbrügge, & Mohr, 2009, Zhao, 2006). Due to the high dissipation risk, the sampled foreign firms could have been reluctant to transfer assets of high specificity to China in the first place or have already developed safeguards to protect their firm-specific assets that do not require high extents of control (Hamel, Doz, & Prahalad, 1989).

Moreover, resource sharing did not significantly influence the extent of control. It is possible that high levels of resource sharing between the parent firm and the foreign subsidiary may reinforce “trust cycles” and increase parent firm’s propensity to refrain from control, relying more on social and noncontractual control mechanisms (Dyer & Chu, 2003, Fryxell, Dooley, & Vryza, 2002). Inkpen and



Curall (2004: 589), for instance, view the concepts of trust and control as “substitutable” and Gulati (1995) argues that trust can compensate the need for contractual types of control.

The type of subsidiary significantly reduced the extent of control over subsidiaries, suggesting that full operation subsidiaries are less controlled than sales and service subsidiaries. This finding is in line with the results of Young et al. (1985) who found that marketing activities are among the most centralized decision areas in subsidiaries.

Although the coefficients for diversification were insignificant, China-specific experience significantly reduced control over subsidiaries which is in line with the results of earlier work (Harzing, 1999, Taggart & Hood, 1999).

In further robustness tests we additionally examined the impact of political distance using Polcon V (Henisz, 2000), economic distance (assessed as the difference in GDP per capita between China and the home country), and geographic distance (measured by distance between China and the home country in kilometers). In addition, we used different operationalizations of cultural distance that we obtained from Schwartz (1994) and the GLOBE study (House, Hanges, Javidan, Dorfman, & Gupta, 2004). Although the signs of the relationship were similar to our results using Hofstede (2001, 1980), regressing the extent of strategic control on these measures did not result in significant main effects and interactions between the ownership mode and the respective distance measure. This is not surprising since scholars debate the usefulness of different cultural distance measures in IB (Hofstede, 2010). Magnusson et al. (2008) found large differences in terms of explanatory power among the cultural frameworks of Hofstede, Trompenaars, Schwartz and GLOBE. Their findings show that the measures of Schwartz and GLOBE “appear to be unrelated to the other constructs and cluster culturally similar markets poorly” (Magnusson, Wilson, Zdravkovic, Joyce Xin, & Westjohn, 2008: 195). Therefore, they maintain that “Schwartz and GLOBE-AI are distinct from the other constructs” (Magnusson, Wilson, Zdravkovic, Joyce Xin, & Westjohn, 2008: 195-196), which may be an explanation for the results in our study.

## **DISCUSSION**

Our research has a number of important implications for IB studies grounded within the agency framework. Previous research has focused on the governance characteristics of a parent firm's ownership stake in an overseas subsidiary often equating it with the extent of control a parent may have over a subsidiary's decision-making process. In this paper, we argue that the choice of ownership mode has a negative effect on the extent of strategic control exerted over foreign subsidiaries with parent firms having higher extent of control over IJVs than over WoS. We theorize that IJVs and WoS represent not only different contractual arrangements but, more importantly, also different types of agency conflicts. While IJVs are relational contracts characterized by multiple principles and agents, WoS represent unilateral contracts with a traditional principal-agent relationship. Specifically, we argue that the complexity of the contractual relationship and ambiguity of subsidiary managers' actions and behavior associated with the joint management of foreign operations jointly lead to higher agency costs for parent firms operating IJVs compared to their counterparts operating WoS. To reduce agency costs, a parent firms may seek a higher control over its subsidiary's strategic decisions. Since agency problems are more significant in IJVs than in WoS, parent firms increase their extent of strategic control more strongly over IJVs than WoS, suggesting that the type of ownership mode can significantly differ from the extent of control exerted over foreign subsidiaries. Therefore, it is necessary to clearly distinguish between ownership rights and the actual extent of control over foreign subsidiaries as "equity position and control are two conceptually different constructs" (Mjoen & Tallman, 1997: 261).

We further extend these arguments by suggesting that agency conflicts in foreign subsidiaries are far from being universal, and they may be contingent on differences in institutional environments between home and host countries. More specifically, we show that the relationship between the choice of ownership mode and the extent of strategic control exerted over foreign subsidiaries depends on the contextual environment such as cultural distance. Our analysis clearly indicates that the level of cultural distance moderates the relationship between ownership mode and the extent of strategic control: the higher the cultural distance, the lower the extent of control over WoS and the higher the extent of control

over IJVs. Our arguments are based on the assumption that cultural distance affects both external and internal uncertainties associated with foreign subsidiaries. We suggest that IJVs and WoS differ in their exposure to external and internal uncertainties associated with cultural distance due to the different contractual relations underlying these ownership modes. While IJVs are characterized by high levels of internal uncertainty, WoS are characterized by lower levels of internal uncertainty. Following prior research, we argue that parent firms respond to this increased internal uncertainty by enhancing the extent of strategic control in IJVs. On the other hand, external uncertainty associated with WoS is higher than with IJVs. In order to mitigate this external uncertainty associated with high cultural distance, parent firms reduce the extent of strategic control and leave decision-making to the WoS. Therefore, cultural distance moderates the relationship between ownership mode and control, with the interplay of external and internal uncertainty levels determining the extent of strategic control parent firms exert over their foreign subsidiaries.

Our study also contributes to research on subsidiary initiatives by suggesting that the extent of control parent firms exert over their subsidiaries does not only depend on their generation and contribution of firm-specific assets (Birkinshaw, Hood, & Jonsson, 1998) or the type of mandate they develop within the global MNC network (Birkinshaw & Morrison, 1995), but also on the type of ownership mode. Moreover, our findings clearly indicate that whether a subsidiary has a “global” or “local mandate” depends not only on the type of ownership mode, but also on the extent of cultural distance between the home country of the parent firm and its subsidiary’s location. Therefore, research on subsidiary initiatives needs to acknowledge that cultural distance affects both the external and internal uncertainty associated with foreign subsidiaries since it complicates the verification of claims of both external and internal agents.

We also make a contribution to IB studies that apply agency theory to describe headquarters-subsidiary relationships (Chang & Taylor, 1999, O'Donnell, 2000, Roth & O'Donnell, 1996). From the agency theory perspective, the extent of strategic control parent firms exert over subsidiaries is a key dimension since agency theory is about “the optimal structuring of control relationships” to manage

uncertainty stemming from the difficulties in verifying the claims from agents (Eisenhardt, 1989: 63).

Following our argument that ownership modes differ in their exposure to uncertainty, we suggest that this research needs to control for the type of ownership mode as the ownership mode determines the contractual relationship within which the parent firm (i.e. the principal) and the foreign subsidiary (i.e. the agent) is embedded in.

Finally, our results provide strong support for the necessity of a simultaneous analysis of internal and external uncertainty to capture the full effect of cultural distance. Therefore, our findings may also help to resolve the “cultural distance paradox” (Brouthers & Brouthers, 2001) in IB literature. In particular, our results suggest that often contradictory empirical evidence regarding the relationship between cultural distance and control may be explained not only by conceptual and methodological shortcomings of the cultural distance constructs (Shenkar, 2001), but also by a failure to control for the type of ownership mode.

### **LIMITATIONS AND FUTURE RESEARCH**

This study has several limitations. First, our dependent variable only captures the extent of strategic control as the actual extent of decision-making that takes place at the parent firm. However, we did not include other dimensions of control mechanisms such as behavioral or social control suggested in the literature (Chang & Taylor, 1999, Eisenhardt, 1989, Ouchi & Maguire, 1975). Prior research has nevertheless argued that nationality or cultural distance influences the dimension of control exerted over foreign subsidiaries (Chang & Taylor, 1999, Egelhoff, 1984, Hedlund, 1981, Lincoln & Kalleberg, 1990, Ouchi, 1981, Pugh, 1998). Therefore, future studies should use a more fine-grained measure of control to account for different control types, which may address uncertainty stemming from cultural distance.

Second, we focused on foreign subsidiaries in one country, the PRC. This approach helps to keep one part of the cultural distance equation constant and thus may lead to a range restriction in our cultural distance variable. Therefore, as range restriction decreases statistical power, our results may generate a

conservative estimate of the effects of cultural distance on the extent of control. Future research should include a broader geographic sample to address this potential shortcoming. Moreover, the size of both parent firms and subsidiaries in our sample was relatively large. Larger firms have more experience and resources to deal with external and internal uncertainty stemming from cultural distance and thus may lead to different levels of control. In order to enhance our understanding future studies should verify whether cultural distance influences the extent of control the SMEs exert over their foreign subsidiaries in a similar way.

Third, from the results of our study we are unable to draw any performance implications. Nevertheless, it would be interesting to analyze how strategic matches/mismatches from the perspective of agency theory influence performance outcomes. Brouthers, Brouthers, and Werner (2003), Brouthers (2002), and Brouthers and Nakos (2004), for instance, have conducted research analyzing possible performance outcomes of similar strategic matches/mismatches with regard to entry mode choices. Future studies could thus adopt their approach and analyze how firms make decisions about the extent of control over their subsidiaries and how these decisions affect performance.

Forth, with regard to IJVs, our focus was on control associated with the foreign parents. However, IJVs may also be exposed to control pressures coming from a Chinese partner, and future research may explore an interface of foreign and Chinese partners in terms of their control priorities in IJVs. Finally, a further limitation concerns the measurement of constructs, their subjective evaluation by a single firm representative and the possibility of common method bias on the level of control variables. In addition, even though we relied on scales that have been used in other research, few of these scales have been designed for a cross-cultural research framework.

## **CONCLUSION**

Building on agency theory, our study indicates that it is crucial to clearly distinguish between ownership rights , i.e. the level of internalization within the Williamson's (Williamson, 1973) market-hierarchy

continuum, and the actual extent of control exerted over foreign subsidiaries. The extent of control does not only depend on the generation and contribution of firm-specific assets or the type of mandate they develop within the global MNC network, but also on the type of ownership mode (IJVs/WoS) as these equity arrangements are subject to different types of agency conflicts. Finally, agency conflicts in foreign subsidiaries are far from being universal, but are influenced by cultural differences between home and host countries. Overall, our study provides important guidance for future agency- and institutionally-grounded research in IB.

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Table 1: Means, standard deviations, and correlations of study variables

Variable	M	SD	1	2	3	4	5	6	7	8	9	10
1. Extent of strategic control	3.21	1.26	--									
2. Ownership mode	0.60	0.49	-.21**	--								
3. Cultural distance	2.50	0.58	-.11	-.03	--							
4. Competitive pressure in industrial sector	5.35	1.36	.09	-.14	-.01	--						
5. Resource sharing	4.06	1.41	-.11	.17*	.13	-.08	--					
6. Asset specificity	3.96	1.65	.08	-.14	-.13	.24**	-.25**	--				
7. Knowledge development	5.54	1.05	-.27**	-.06	.11	.18*	.13	-.09	--			
8. Age of subsidiary	8.64	5.98	.07	-.10	.03	.13	-.01	-.14	.25**	--		
9. Type of subsidiary	0.85	0.36	-.14	-.16*	.05	.04	.22**	-.01	.12	.01	--	
10. Diversification	0.17	0.38	.16*	-.14	.01	-.09	-.20*	-.02	-.15	-.01	.05	--
11. China-specific experience	7.25	10.79	-.03	-.16*	-.14	.08	-.14	-.04	.03	.18*	-.12	.10

Notes. N = 156. Ownership mode (0 = International Joint Venture; 1 = Wholly Owned Subsidiary), Type of subsidiary (0 = sales & service; 1 = full operation), and Diversification (0 = same as parent firm; 1 = different from parent firm) are dichotomous variables. Dummy variables for SIC divisions are not shown.

\* p < 0 .05; \*\* p < 0 .01

Table 2: Regression of extent of strategic control on study variables

Variable	M 1	M 2	M 3
Constant	4.89 (0.80)	5.42 (0.81)	5.42 (0.78)
SIC code			
Division A (Agriculture)	-0.36 (0.88)	-0.30 (0.86)	-0.37 (0.84)
Division E (Transportation)	-0.33 (0.68)	-0.51 (0.66)	-0.51 (0.65)
Division F (Wholesale Trade)	-0.58 (0.95)	-0.83 (0.93)	-0.73 (0.91)
Division G (Retail Trade)	0.55 (1.25)	0.16 (1.24)	-0.06 (1.21)
Division H (Finance)	-1.06 (0.73)	-1.02 (0.71)	-0.77 (0.70)
Division I (Services)	-0.66 <sup>+</sup> (0.38)	-0.51 (0.37)	-0.43 (0.36)
Competitive pressure in industrial sector	0.14 <sup>+</sup> (0.08)	0.12 (0.08)	0.14 <sup>+</sup> (0.07)
Resource sharing	-0.01 (0.08)	0.03 (0.08)	0.03 (0.08)
Asset specificity	0.01 (0.06)	-0.02 (0.06)	-0.02 (0.06)
Knowledge development	-0.36 <sup>**</sup> (0.10)	-0.35 <sup>**</sup> (0.10)	-0.36 <sup>**</sup> (0.10)
Age of Subsidiary	0.03 <sup>+</sup> (0.02)	0.03 <sup>+</sup> (0.02)	0.03 <sup>+</sup> (0.02)
Type of subsidiary	-0.72 <sup>*</sup> (0.33)	-0.88 <sup>**</sup> (0.33)	-0.83 <sup>*</sup> (0.32)
Diversification	0.49 <sup>+</sup> (0.27)	0.44 (0.27)	0.37 (0.26)
China-specific experience	-0.02 (0.01)	-0.02 <sup>*</sup> (0.01)	-0.02 <sup>**</sup> (0.01)
Ownership mode		-0.59 <sup>**</sup> (0.21)	-0.60 <sup>**</sup> (0.20)
Cultural distance		-0.12 (0.10)	0.15 (0.14)
Ownership mode * Cultural distance			-0.54 <sup>**</sup> (0.19)
Total $R^2$	.18 <sup>**</sup>	.23 <sup>**</sup>	.28 <sup>**</sup>
$\Delta R^2$		.05 <sup>*</sup>	.04 <sup>**</sup>

*Note.*  $N = 156$ . Ownership mode (0 = International Joint Venture; 1 = Wholly Owned Subsidiary), Type of subsidiary (0 = sales & service; 1 = full operation), and Diversification (0 = same as parent firm; 1 = different from parent firm) are dichotomous variables. SIC Division D (Manufacturing) was used as reference category. Cultural distance was standardized for this analysis.

<sup>+</sup>  $p < 0.10$ ; <sup>\*</sup>  $p < 0.05$ ; <sup>\*\*</sup>  $p < 0.01$