Reducing cultural uncertainty through experience gained in the domestic market

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A B S T R A C T

This paper addresses one of the major debates in the international strategy literature: whether the transfer of experiential knowledge is bound within the cultural boundary of a firm's home country. We argue that some experienced firms can transfer experiential knowledge gained in their domestic market or foreign market to the focal host country in their initial investment. Drawing on the organizational learning literature, this study proposes the boundary conditions under which multinational corporations (MNCs) with experiential knowledge gained in their domestic markets through joint ventures with foreign partners benefit in their initial entry into the host country. The results provide support for the hypotheses, and according to the empirical analysis, MNCs' cross-border joint-venture experience gained in the domestic market can facilitate their expansion into host countries culturally similar to foreign partners' originating countries by reducing cultural uncertainty perceived in the focal host country with respect to doing business in general.

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1. Introduction

A firm's initial foreign direct investment (FDI) in a host country is an important strategic decision because it can provide opportunities for future growth in the country by committing resources that can be transferred between initial and subsequent investments in the country (Belderbos & Zou, 2009; Chang, 1995; Johanson & Vahlne, 1977; Kogut & Chang, 1996; Song, 2002). In addition, the initial investment is more difficult to manage than any subsequent investment because, by definition, firms engaging in an initial investment may not be able to make use of any experiential knowledge from prior FDI experience gained in the host country. However, despite the importance of the initial investment for future growth opportunities, an MNC is not likely to make the initial investment in every possible host country because it not only has limited resources but also faces different levels of uncertainty across host countries (Belderbos & Zou, 2009; Lee & Makhija, 2009).

With the context set as this initial investment, this study addresses two important questions in the international strategy literature: First, do firms with related experiential knowledge face less cultural uncertainty in the host country and therefore thus be more likely to enter the country than those firms without such foreign-market knowledge? Second, are firms with related experiential knowledge able to make more effective use of their experiential knowledge in culturally similar host countries than in dissimilar ones? Korean electronics firms are known for their prolific outward (i.e., expansion into foreign markets) and inward (i.e., collaboration with foreign partners in the domestic market) FDI throughout their firm capability development processes (Lee & Lim, 2001). Therefore, setting them as the empirical context, this study tests some hypotheses by drawing on the argument about experiential knowledge transfer between cultural boundaries.

According to organizational learning theory, related experiential knowledge is either fungible only within a country (i.e., country-specific market knowledge) or globally fungible regardless of national boundaries (i.e., general foreign-market knowledge). However, previous studies have identified that experiential knowledge may be employed neither in a country-specific manner only nor in a globally fungible way (Chemawat, 2003). This notion is important for the initial investment literature in that a firm making an initial investment in a host country may not able to rely on any prior experience if experiential knowledge is fungible only within the country (Chang, 1995; Johanson & Vahlne, 1977).
To fill this research gap in boundary conditions of experiential knowledge surrounding initial investment decisions, this study proposes an argument about experiential knowledge transfer. More specifically, a firm’s task-specific and indirect prior experience gained through joint venture (JV) experience with a foreign partner in the domestic market (i.e., inward-JV experience) would be more effectively transferred within cultural boundaries of the firm’s home country, whereas a firm’s general and direct prior experience gained through FDI in a host country other than the focal host country (i.e., outward-FDI experience) would be transferred both within and beyond cultural boundaries of the firm’s home country.

This notion can provide important theoretical and empirical contributions to the international strategy literature as follows: First, theoretically, this study extends the literature by arguing that MNCs make their initial investment decisions based on their related experiential knowledge gained (either in the domestic market or a host country) before entering a focal host country. Most studies have implicitly assumed that experiential knowledge transfer is mainly a country-specific learning process (Anand & Delios, 1997; Barkema & Vermeulen, 1998; Delios & Beamish, 2001; Hennart & Park, 1993). The present study extends this conventional thought and posits that, within cultural boundaries between culturally similar countries, MNCs can effectively transfer their experiential knowledge, including their prior domestic market experience with foreign partners, across national boundaries.

Second, this study is one of pioneering efforts to empirically test the effects of inward-JV experience on initial investment. Here this effect refers to the impact of an MNC’s prior experience gained by forming and managing a JV with a foreign partner in its domestic market on its entry into a host country culturally close to the originating country of the foreign partner. Although the notion that links prior inward-FDI experience to later outward-FDI entry is important, the international strategy literature has paid little attention to this notion except for a few studies (e.g., Welch & Luostarinen, 1993). Using a unique data set constructed from de facto population data on Korean firms’ FDI, the present study empirically tests some theoretical predictions in the context of initial investment by publicly-traded Korean electronics firms.

2. Theory Development

2.1. The costs of doing business abroad and cultural uncertainty

When an MNC makes an initial investment in a host country, it may encounter substantial costs arising from its presence in the country, costs not imposed on local firms (Eden & Miller, 2004; Zaheer, 1995, 2002). Previous studies have suggested three sources of the cost of doing business abroad: unfamiliarity, discrimination, and relational hazards (Eden & Miller, 2004; Mezias, 2002; Zaheer, 2002). Unfamiliarity hazards refer to some uncertainty derived from a lack of local knowledge about the host country; discrimination hazards, some uncertainty arising from a lack of local legitimacy; and relational hazards, some uncertainty in the management of relationships with business partners (Eden & Miller, 2004). In sum, when an MNC makes an initial investment in a host country, it may face various uncertainties including unfamiliar local market environments, local stakeholders discriminating against foreign firms, and some difficulty predicting business partners’ behaviors.

The international strategy literature identifies that such costs of doing business abroad mainly stem mainly from cultural differences between home and host countries (Barkema, Bell, & Pennings, 1996; Benito & Gripsrud, 1992; Davidson, 1980; Kogut & Singh, 1988). In general, previous studies have highlighted that firms are more likely to invest in countries where they perceive a lower level of uncertainty and thus expect a lower cost of doing business (Davidson, 1980; Johanson & Vahlne, 1977). In particular, a firm is more familiar with the local business environment, perceives less outsidership in the country, and perceives less opportunism from business partners in a culturally similar host country than in a culturally dissimilar one (Delios & Henisz, 2003; Johanson & Vahlne, 2009; Luo, 2005).

The concept of “cultural clusters,” as an important construct that can capture the impact of cultural differences between home and host countries, has been proposed to identify cultural boundaries across countries (Gupta, Hanges, & Dorfman, 2002; Lee, Shenkar, & Li, 2008; Ronen & Shenkar, 1985). This concept is useful for clarifying the impact of cultural differences on the probability of initial investment because it can be predicted that, all else being equal, firms embedded in two countries sharing similar cultural values would perceive a similar level of uncertainty concerning their business environments. Within a cultural cluster, customers, business partners, government authorities, competitors, and other stakeholders may share similar cultural values across countries (Cartwright & Cooper, 1993; Lee et al., 2008; Reus & Lamont, 2009; Shenkar, 2001). In the same vein, when a firm enters a culturally dissimilar host country (i.e., a host country beyond the cultural cluster of the firm’s home country), it may face a higher cost of doing business abroad than when it enters a culturally similar one (i.e., a host country within the cultural cluster of the firm’s home country). If local customers, business partners, government authorities, and competitors in a host country within a cultural cluster view a given business environment or a given decision-making situation from a similar perspective (Reus & Lamont, 2009), then all else being equal, firms within the cluster may perceive a similar level of uncertainty.

Noteworthy is that other conditions are often not equal even between firms expanding from the same home country. The perceived cost of doing business in a host country may vary across firms because firms with different levels of foreign-market knowledge would perceive different levels of uncertainty concerning their initial investment in the country. The present study refers to the uncertainty that stems from cultural differences between home and the host countries and generates perceived cost of doing business in a host country as “cultural uncertainty” because each firm in the same host country perceives cultural uncertainty differently (Cuypers & Martin, 2010; Slangen & Beugelsdijk, 2010).

In sum, cultural uncertainty is a major source of the cost of doing business abroad, and each firm from the same home country may perceive a different level of cultural uncertainty when entering the same host country because of differences in the level of prior experience.

2.2. Types and cultural boundaries of prior related experience

Because initial investment is the first market entry through FDI into a host country, it is essential to reduce the level of cultural uncertainty. The transfer of experiential knowledge tends to be bound by the context in which a firm’s focal knowledge is gained and accumulated (Kogut & Zander, 1993; Szulanski, 1996). In the case of initial investment, there are two types of prior experience that MNCs can transfer to the host country to reduce cultural uncertainty: (1) outward-FDI experience gained in another host country culturally similar to the focal host country and (2) inward-JV experience gained in the domestic market by partnering with a foreign firm originating from another country culturally similar to the focal host country.

Previous studies have comprehensively addressed the effects of outward-FDI experience gained in other countries on entry into the focal host country (Barkema et al., 1996; Delios & Beamish, 2001; Delios & Henisz, 2003). Because firms with FDI experience gained in countries culturally similar to the focal host country are likely to
perceive a higher level of familiarity with the local market, higher legitimacy as insiders, and better predictability regarding local business partners’ behaviors than those firms with no such FDI experience, they are more likely to enter the country (Delios & Henisz, 2003; Eden & Miller, 2004).

By contrast, few international strategy studies have examined the effects of inward-JV experience gained in the home country with partners from countries culturally similar to the focal host country. This is mainly because previous studies have generally assumed that the transfer of experiential knowledge is bound within national boundaries (Eriksson, Johanson, Majkgård, & Deo Sharma, 1997; Johanson & Vahlne, 1977). However, recent studies have suggested that this transfer may not necessarily be bound within national boundaries (Pedersen & Shaver, 2011; Vermeulen & Barkema, 2001). In this regard, the present study posits that the transfer of experiential knowledge is bound within a cultural boundary as long as key economic players within a cultural cluster view uncertainty in the business environment from a similar perspective (Ronen & Shenkar, 2013). When countries are substantially similar in terms of their cultural background, such as their historical roots (Makino & Tsang, 2011), MNCs may effectively transfer experiential knowledge gained in one country to another within the same cultural cluster (Lee et al., 2008; Ronen & Shenkar, 1985). In a similar vein, MNCs may not be able to effectively transfer experiential knowledge gained in one country to another when these countries do not belong to the same cultural cluster.

This raises question based on the notion of cultural boundaries across groups of countries. Assume that an MNC from the home country (e.g., Korea) can effectively transfer its outward-FDI experience gained in a host country (e.g., New Zealand) to the focal host country (e.g., Australia, which belongs to the same cultural cluster as New Zealand). Then can the MNC also transfer its inward-JV experience gained in its home country (Korea) through the partner originating from New Zealand when entering Australia? This question may not be answered simply by the cultural boundary argument alone.

To address this question, the context in which the MNC gains and accumulates experiential knowledge between its outward-FDI and inward-JV experience should be considered. When the MNC from Korea enters New Zealand through outward FDI, it can directly expose itself to all aspects of business environments within New Zealand, including familiarity, discrimination, and relational hazards. It can accumulate a wide range of general experience, including how it should manage its local customers, business partners, competitors, government authorities, and various other stakeholders regarding all three hazards (Eden & Miller, 2004; Johanson & Vahlne, 2009). Therefore, as long as customers, business partners, competitors, and government authorities in the focal host country (Australia) share similar cultural values with those in New Zealand, it can transfer its general experience gained in New Zealand to its initial investment in Australia to reduce the level of uncertainty arising from market familiarity, local legitimacy, and business partner management.

By contrast, when the MNC forms an inward JV in its home country (Korea) with a partner originating from New Zealand, which belongs to the Anglo cultural cluster together with the focal host country (Australia), it may be exposed only to major characteristics of the Anglo cultural cluster through its partner from New Zealand. Because a cross-border JV involves learning about different cultural values of a country as well as about those of an organization, the focal firm faces a complex acculturation process across countries and organizational boundaries (Barkema, Shenkar, Vermeulen, & Bell, 1997; Sirmon & Lane, 2004). In other words, reducing cultural uncertainty through an inward JV is a very task-specific and indirect experience accumulation process. Although Korean MNCs can be indirectly exposed to ways New Zealand firms manage their businesses, any reduction in their cultural uncertainty can occur only through the organizational prism of their foreign partners (Barkema et al., 1997; Nummela, 2003). Because of the structural nature of inward JVs, the MNC may not be fully benefited from all three dimensions of reductions in cultural uncertainty. In this regard, the present study posits that inward-JV experience is more effective in reducing relational hazards than familiarity or discrimination hazards. For example, a Korean firm’s inward-JV experience with a foreign partner from New Zealand may better identify local partners’ potential opportunism when it enters Australia. However, this inward experience may not effectively increase its perceived familiarity with target markets within the Anglo cultural cluster when it pursues initial investment opportunities in Australia.

In terms of the effectiveness of experiential knowledge transfer, this study proposes two theoretical premises (see Fig. 1 for the theoretical framework). First, task-specific/indirect experience through inward-JVs is effectively fungible within the cultural cluster of a firm’s home country because learning through inward experience is determined by the cultural similarity between home and focal host countries.

<table>
<thead>
<tr>
<th>Task-specific/indirect experience effect (inward-JV experience gained in the home country): The fungibility of experience is determined by the cultural similarity between home and focal host countries</th>
<th>General/direct experience effect (outward-FDI experience gained in other host countries within the same cultural cluster as the focal host country): The fungibility of experience is determined by the cultural similarity between originating and focal host countries</th>
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</thead>
<tbody>
<tr>
<td>The focal host country: Within the home country’s cultural cluster</td>
<td>Fungible</td>
</tr>
<tr>
<td>The focal host country: Outside the home country’s cultural cluster</td>
<td>Not fungible</td>
</tr>
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Fig. 1. Fungibility of experiential knowledge by experience type and cultural boundary.

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experience occurs in the domestic market. Therefore, within an MNC, the parent firm is the source organizational unit that has to absorb experiential knowledge from the inward JV and transfer it to the focal host country (Kogut & Zander, 1993). If the focal host country is culturally distant from the home country, then the parent firm, as the source unit of experiential learning, may not be able to effectively transfer its inward-JV experience to the focal host country.

Second, general/direct experience through outward-FDIs is effectively fungible both within and beyond the cultural cluster of a firm's home country. If a Korean firm enters New Zealand first and then Australia later, then the New Zealand subsidiary is the source organizational unit that has to absorb experiential knowledge gained in the New Zealand market and transfer it to the Australian market. Unlike in the case of inward experience, as long as prior outward-FDI experience is gained in other host countries culturally similar to the focal host country, the source unit of experiential knowledge (in this case, the New Zealand subsidiary) can effectively transfer its prior outward-FDI experience to the focal host country (in this case, Australia).

In sum, in the case of reducing cultural uncertainty by transferring outward-FDI experience gained in other host countries, the cultural similarity between home and focal host country per se may not affect the effectiveness of the transfer of experiential knowledge. Instead, the cultural similarity between originating country of experiential knowledge and focal host country may determine the effectiveness of this experience transfer because the source unit of experiential knowledge is the MNC's subsidiary, unlike in the case of the transfer of inward-JV experience.

2.3. Hypotheses

2.3.1. Inward-JV experience and the probability of initial Investment

From a firm's perspective, the level of cultural uncertainty it faces in a host country may be incrementally reduced once it enters the country (Folta, 1998). When reducing uncertainty, the firm may face three major dimensions of cultural uncertainty including familiarity, discrimination, and relational hazards. Without any related prior experiential knowledge that can help reduce these sources of cultural uncertainty, firms may be hampered when entering host countries culturally dissimilar to their home countries (Benito & Gripsrud, 1992; Davidson, 1980; Johanson & Vahlne, 2009).

However, a firm can reduce the level of cultural uncertainty before it makes an initial investment in the focal host country by forming an inward JV in its home country with a partner from a foreign market. When a firm forms an inward JV with a partner within the cultural cluster of its home country, it can effectively gain substantial cultural understanding of managing foreign customers, governments, and competitors in the cultural boundary, although it gains such knowledge through the lens of these partners (Barkema et al., 1997; Sirmon & Lane, 2004). In other words, within its home country's cultural boundary, the firm's prior experience is fungible across countries. Because of the cultural similarity between its home and focal host countries, the firm may be able to gain and accumulate experiential knowledge even through the lens of its JV partners (Rothaermel, Kotha, & Steensma, 2006). Therefore, the cultural similarity between its home and focal host countries can reduce cultural uncertainty through inward-JV experience and consequently facilitate the probability of initial investment in the country. In this regard, the following hypothesis is proposed:

**Hypothesis 1a.** Inward-JV experience with a foreign partner from a country within the focal host country's cultural cluster is positively related to the probability of initial investment in the focal host country within the cultural cluster of the investing firm's home country.

When a firm tries to transfer its inward-JV experience to a host country beyond the cultural cluster of its home country, a lack of the parent firm's (source organizational unit's) capability to transfer experiential knowledge stemming from cultural uncertainty can matter (Szulanski, 1996). When the parent firm gains some market knowledge about distant cultural clusters and transfer such experiential knowledge gained through inward JV to the focal host country beyond the cultural boundary of its home country, the cultural dissimilarity between its home and focal host countries can hinder the fungibility of its experiential knowledge (Reus & Lamont, 2009). In particular, because inward-JV experience is gained through the foreign partner's lens in the firm's home market, it may perceive some difficulty in reducing familiarity and discrimination hazards relative to relational ones due to task-specific/indirect nature of the experience (Eden & Miller, 2004). Therefore, the task-specific and indirect nature of inward-JV experience can hinder the effective transfer of experiential knowledge beyond the cultural cluster of the firm's home country (Shenkar, Luo, & Yeheskel, 2008; Sirmon & Lane, 2004). Consequently, the cultural dissimilarity between home and focal host countries is not likely to facilitate the probability of initial investment in the focal host country. In this regard, the following hypothesis is proposed:

**Hypothesis 1b.** Inward-JV experience with a foreign partner from a country within the focal host country's cultural cluster has no effect on the probability of initial investment in the focal host country outside the cultural cluster of the investing firm's home country.

2.3.2. Outward-FDI experience and the probability of initial investment

The cultural boundary condition of general and direct experiential knowledge (outward-FDI experience) is different from that of task-specific and indirect experiential knowledge (inward-JV experience). Because outward-FDI experience gained in other host countries within the cultural cluster of the focal host country is accumulated and transferred by a firm's subsidiaries in these countries, the cultural dissimilarity between the firm's home and focal host countries matters less when it transfers experiential knowledge to the focal host country (Perkins, 2008). The source unit of experiential knowledge (subsidiaries in each host country) can accumulate a broad range of exposure concerning local customers, government authorities, competitors, and employees who share similar cultural values with those in the focal host country (Brouthers, 2002). In other words, as long as the source organizational unit can accumulate general market knowledge through prior outward-FDI entries, the firm can reduce the three major sources of cultural uncertainty (familiarity, discrimination, and relational hazards) regarding local business environments in the focal host country by transferring this experiential knowledge to the country. On the other hand, the cultural similarity between the originating country of experiential knowledge (i.e., another host country entered earlier) and the focal host country can reduce cultural uncertainty and consequently facilitate the probability of initial investment in the focal host country. Therefore, this general and direct nature of outward-FDI experience can produce the same prediction about the effects of experience transfer within and beyond the cultural cluster of an MNC's home country. In this regard, the following hypotheses are proposed:

**Hypothesis 2a.** Within the home country's cultural cluster, outward-FDI experience gained in other host countries within the focal host country's cultural cluster is positively related to the probability of initial investment in the focal host country.

**Hypothesis 2b.** Outside the home country's cultural cluster, outward-FDI experience gained in other host countries within the
focal host country's cultural cluster is positively related to the probability of initial investment in the focal host country.

3. Methodology

3.1. Data and Sampling

To test the hypotheses, a comprehensive sample of initial investments by 42 publicly traded Korean electronics firms in 53 focal host countries for the following reasons: First, Korean MNCs have initiated their FDI waves more recently than those from developed countries (Chang & Rhee, 2011). Korean firms were required by law to report all FDI events exceeding USD 1 million to the state-owned Export–Import Bank of Korea until 2004 (Chang & Rhee, 2011; Kim, Kim, & Hoskisson, 2010). According to population data on Korean firms’ FDI in the broadly defined electronics industry, the first FDI by a Korean MNC was made in 1981. Therefore, the relatively short history of Korean MNCs attenuates some concern over the left-censoring problem because one can observe whether the focal firm made an initial investment in a host country between 1981 and 2003 based on the data set.

Second, the electronics industry is known for a high level of technological uncertainty (Lee & Lim, 2001). If MNCs operating under a high level of industry-specific uncertainty are influenced by a reduction in cultural uncertainty in their initial investment decisions, then it can be conservatively predicted that MNCs operating under a low level of industry-specific uncertainty would carefully consider their prior experience to reduce cultural uncertainty.

Third, Korean electronics firms have traditionally developed their technological capability through vertical linkages with MNCs from developed countries such as Japan, the U.S., and Western European countries (Slagten & Beugelsdijk, 2010; Song, 2002). Therefore, Korean electronics firms have enjoyed a broad range of opportunities from inward JVs with partners from both culturally similar and dissimilar originating countries, particularly because foreign partners from developed countries may want to exploit cheaper skilled labor during the earlier stage of Korean electronics firms’ technological capability development (Kim, 1997).

The sample was constructed using two categories: (1) firms listed on the Korea Stock Exchange (KSE) as of December 2011 and (2) firms listed on the KSE before 1981 and eventually delisted before December 2011. Within the electronics industry broadly defined based on two-digit Korea Standard Industrial Classification (KSIC) codes, 45 firms were listed on the KSE as of December 2011. Among these, 35 were established before 1981. In addition, 7 firms delisted before 2011 but listed before 1981 were included in the sample. A total of 42 publicly traded Korean electronics firms were considered for firm-level financial information from the Korea Information Service (KIS) database, verified as one of the most reliable sources of data for research on Korean firms (e.g., Chang & Park, 2005).

Based on Peng, Hill, and Wang (2000), to determine the scope of focal host countries and cultural clusters, the analysis referred mainly to Ronen and Shenkar’s (1985) original classification and subsequently augmented with Gupta et al.’s (2002) classification mainly because Ronen and Shenkar’s classification did not include several major markets of Korean electronics firms. For instance, China is a major market/manufacturing site for Korean electronics firms (Chang & Park, 2005) but was not included in Ronen and Shenkar’s original classification. Therefore it has not been included in other studies for this reason (Peng et al., 2000), although these countries share Confucian cultural values with the Far Eastern cluster (Ronen & Shenkar, 2013). Gupta et al. (2002) classified China as part of the Confucian Asia cluster. Following this notion, the Far Eastern cluster, including China, as the home country cluster of Korean electronics firms (see Table 1).

3.2. Empirical specification

The hypotheses were tested using a multilevel mixed effects logit (MMEL) model. An important advantage of using the MMEL model is that the effects of firm-specific experience factors on the probability of each firm’s initial investment conditional on country-specific characteristics of the focal host country can be

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estimated (Poghosyan & De Haan, 2010). This statistical feature is important in that each firm’s initial investment decision is nested within each focal host country’s institutional characteristics, including market size and growth. Here the specification of the MMEL model expressed in the log odds ratio is as follows:

$$\log \left( \frac{P_{ij}}{1 - P_{ij}} \right) = \beta_0 + \beta_1 \times EXPERIENCE_{ij} + \beta_2 \times CONTROLS_{ij}$$

(1)

where $$P_{ij}$$ is the probability that firm $$i$$ makes an initial investment in the focal host country $$j$$ in the sample period (1981–2003) conditional on the following set of explanatory variables; $$EXPERIENCE_{ij}$$ is the vector of inward-JV experience and outward-FDI experience that firm $$i$$ attempts to transfer to the focal host country $$j$$; $$CONTROLS_{ij}$$ is the vector of country- and firm-specific control variables; and $$\beta$$ are the parameters to be estimated. This MMEL model relaxes the assumption that the parameters $$\beta$$ are constant across focal host countries (Poghosyan & De Haan, 2010).

In this sense, the MMEL model nests the traditional logistic regression model and allows for an examination of the importance of country-level heterogeneity based on a likelihood ratio test (Arregle, Hebert, & Beamish, 2006; Poghosyan & De Haan, 2010). Because the unit of analysis was the firm-country entry pair, there was a total of 2226 (=42 × 53) observations for the analysis.

3.3. Measurement of variables

3.3.1. Dependent variable

The dependent variable is a binary variable taking the value of 1 if firm $$i$$ entered the focal host country $$j$$ during the 1981–2003 period through FDI and 0 otherwise. To identify the FDI history of sample firms, the FDI database constructed by the Export–Import Bank of Korea was employed, and it was cross-checked with FDI entry data reported in the “Directory of Foreign Affiliates in Electronics Industry” by the Electronics Industry Association of Korea.

3.3.2. Independent variables

3.3.2.1. Inward-JV experience. Inward-JV experience is coded as 1 if firm $$i$$ had prior JV experience in its home country with a foreign partner from another country within the same cultural cluster as the focal host country $$j$$ before $$i$$ makes an initial investment in $$j$$ and 0 otherwise. To construct this variable, the firm was checked to determine whether it gained inward-JV experience through a partnership with a foreign partner from a country within the cultural cluster of the focal host country using the “Directory of Registered Foreign Investors” by the Korea Ministry of Finance. When the information on parent firms reported in this directory could not be clearly verified, we also crosschecked the firm’s annual reports and corporate Websites to track its history. To determine whether a host country belonged to the same cultural cluster as the focal host country, the classification suggested in Ronen and Shenkar (1985) was employed. When the focal host country was ambiguous for its classification, we referred to both Gupta et al. (2002) and Zeng, Shenkar, Lee, and Song (2013).

3.3.2.2. Outward-FDI experience. Outward FDI experience is coded as 1 if firm $$i$$ had prior experience from FDI entry into another country within the same cultural cluster as the focal host country $$j$$ before $$i$$ made an initial investment in $$j$$ and 0 otherwise. To construct this variable, the population database of outward FDI constructed by the Export–Import Bank of Korea was employed.

3.3.3. Control variables

3.3.3.1. Home cluster. Home cluster is a binary variable taking value of 1 if the focal host country belonged to the same cultural cluster as the firm’s home country (i.e., Korea) and 0 otherwise. We posit that an MNC faces a lower level of cultural uncertainty when it enters a focal host country within the cultural cluster of its home country than a country beyond its home cluster (Slangen & van Tulder, 2009).

3.3.3.2. Firm size. The natural logarithm of the parent firm’s average total sales during the representative sample period is used to consider the effect of economies of scale on corporate international expansion (Kim et al., 2010). Because Korean electronics firms’ FDI increased sharply between 1987 and 1996 before the Asian Financial Crisis (Chang & Rhee, 2011), the average value of this 10-year period was employed. Here large firms are assumed to have more slack resources for foreign markets than small ones (Tan & Peng, 2003).

3.3.3.3. Parent firm’s investment in marketing capabilities. Advertising intensity (the percentage of advertising expenditure to total sales) for the 1987–1996 period is used as a proxy for the parent firm’s investment in marketing capabilities. Based on Delios and Beamish (2001), the parent firm’s investment in intangible marketing assets was assumed to increase the probability of its foreign market entry.

3.3.3.4. Parent firm’s investment in technological capabilities. R&D intensity (the percentage of R&D expenditure to total sales) is used as a proxy for the parent firm’s investment in technological capabilities. Based on Henisz and Macher (2004), a positive relationship between R&D intensity and the probability of foreign market entry was assumed.

3.3.3.5. Investment irreversibility. Following Li and Li (2010), a sub-industry-level (four-digit K5IC codes) ratio of fixed assets was used to measure the investment irreversibility of the industry in which the focal firm operated within the broadly defined electronics industry. The ratio of fixed assets to total assets was calculated for each sub-industry, and the average was taken to capture the level of investment irreversibility. Here a high level of investment irreversibility for the sub-industry in which the focal firm primarily operates was assumed to reduce the probability of foreign market entry because an increased sunk cost (Campa, 1993).

3.3.3.6. Market size. Following Slangen and Beugelsdijk (2010), the natural logarithm of the average total population of the focal host country was used to measure its market size. Some studies have used GDP size instead of population size because the host country’s customers with substantial purchasing power can provide better growth opportunities in the focal host country (Tsang & Yip, 2007). In the present study, population size is used as a proxy for market size because the population size of several emerging markets has been a main driver of Korean MNCs’ investment in these emerging markets (Kwon, 2010).

3.3.3.7. Market growth. Based on Slangen and Beugelsdijk (2010), firms were assumed to be more likely to enter fast-growing markets. The market growth of the focal host country is measured using the average of annual growth rate of GDP per capita.

3.3.3.8. Exchange rate volatility. Following Li and Li (2010), the average value of the coefficient of variation of the monthly exchange rate for the focal host country’s currency with respect to the U.S. Dollar each year over the 1987–1996 period is used to measure exchange rate volatility. To calculate exchange rate volatility, the Federal Reserve Board (FRB) exchange rate database was employed. This cross-country variation provides a better measurement method for capturing the level of exchange rate uncertainty than that in previous studies (e.g., Lee & Makhija, 2009).
In the case of entry into the U.S. market, the exchange rate of the Korean Won against the U.S. Dollar (KRW/USD) was used.

4. Results

Table 2 shows the descriptive statistics and correlations for the variables used in the full-sample analysis. Because the effects of explanatory variables were assumed to vary across cultural boundaries, the full sample was divided into two sub-samples: (1) a possible firm-country entry pair within the home country’s cultural cluster and (2) a possible firm-country entry pair outside the home country’s cultural cluster. Tables 2a and 2b present correlation tables for each sub-sample. The results for correlations between key variables indicate that multicollinearity is not a serious concern.

Table 3 shows the results for the full sample. Before country-specific control variables were added, a logistic regression model was run without them (Model 1). Consistent with the conventional wisdom in the organizational learning literature, the home cluster had a significant positive effect on the probability of initial investment \((p < .001)\), indicating that firms are less likely to pursue initial investment in culturally dissimilar host countries than in culturally similar ones.

Model 2 introduces the MMEL model by adding country-specific variables, including exchange rate volatility, market size, and market growth. Because the MMEL model relaxes the assumption of constant parameters across countries, the intercept term was assumed to possible vary across countries. According to Model 2, market size is positively related to the probability of initial investment \((p < .001)\), whereas exchange rate volatility is negatively related to it \((p < .01)\). According to the results for the log-likelihood ratio test, the use of the MMEL model vis-à-vis simple logit model is justified \((p < .001)\).

Table 4 shows the results for Models 3 and 4 for Hypothesis 1a (H1a), which predicted that reducing cultural uncertainty through inward-JV experience would facilitate initial investment within the cultural cluster of the firm’s home country as a result of the cultural similarity between home and focal host countries in transferring experiential knowledge. The results for both the logit model (Model 3) and the MMEL model (Model 4) show that inward-JV experience gained within the home country’s cultural cluster significantly increases the probability of initial investment in the focal host country within the Far Eastern cluster, that is, the

**Table 2**
Descriptive statistics and correlation matrix (full sample).

<table>
<thead>
<tr>
<th>Variables</th>
<th>Mean</th>
<th>SD</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
<th>6</th>
<th>7</th>
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</thead>
<tbody>
<tr>
<td>1. Home cluster</td>
<td>0.19</td>
<td>0.39</td>
<td></td>
<td></td>
<td></td>
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<td>2. Firm size</td>
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<td>1.67</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3. Parent investment in marketing capability</td>
<td>0.66</td>
<td>0.79</td>
<td>0.00</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>4. Parent investment in technological capability</td>
<td>1.26</td>
<td>1.37</td>
<td>0.00</td>
<td>0.13</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>5. Investment irreversibility</td>
<td>55.40</td>
<td>15.84</td>
<td>0.00</td>
<td>0.07</td>
<td>0.23</td>
<td></td>
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<tr>
<td>6. Market size</td>
<td>2.82</td>
<td>0.08</td>
<td>0.23</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>7. Market growth</td>
<td>2.33</td>
<td>2.74</td>
<td>0.63</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>8. Exchange rate volatility</td>
<td>46.84</td>
<td>44.60</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
<td>0.37</td>
<td></td>
<td></td>
<td>0.22**</td>
</tr>
</tbody>
</table>

N=2226 refers to the number of observations used in the full sample analyses.

\* \(p < .05\)

\** \(p < .01\)

**Table 2a**
Correlation matrix (home cluster sub-sample).

<table>
<thead>
<tr>
<th>Variables</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
<th>6</th>
<th>7</th>
<th>8</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Inward experience</td>
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<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2. Outward experience</td>
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<td></td>
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<td></td>
<td></td>
</tr>
<tr>
<td>3. Firm size</td>
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<td>.13</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>4. Parent investment in marketing capability</td>
<td>.07</td>
<td>.06</td>
<td>.51</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>5. Parent investment in technological capability</td>
<td>-.30</td>
<td>-.08</td>
<td>.13</td>
<td>.13</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>6. Investment irreversibility</td>
<td>.01</td>
<td>-.06</td>
<td>.07</td>
<td>.23</td>
<td>-.21</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>7. Market size</td>
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<td>.00</td>
<td>.00</td>
<td>.00</td>
<td>.00</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>8. Market growth</td>
<td>.00</td>
<td>.00</td>
<td>.00</td>
<td>.00</td>
<td>.00</td>
<td>.00</td>
<td></td>
<td></td>
</tr>
<tr>
<td>9. Exchange rate volatility</td>
<td>.00</td>
<td>.00</td>
<td>.00</td>
<td>.00</td>
<td>.00</td>
<td>.00</td>
<td>.63</td>
<td>-.19**</td>
</tr>
</tbody>
</table>

N=420 refers to the number of observations used in the home cluster sub-sample analyses.

\* \(p < .05\)

\** \(p < .01\)

**Table 2b**
Correlation matrix (other clusters sub-sample).

<table>
<thead>
<tr>
<th>Variables</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
<th>6</th>
<th>7</th>
<th>8</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Inward experience</td>
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<td></td>
<td></td>
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<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2. Outward experience</td>
<td>.25</td>
<td></td>
<td></td>
<td></td>
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<td></td>
<td></td>
</tr>
<tr>
<td>3. Firm size</td>
<td>.21</td>
<td>.32</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>4. Parent investment in marketing capability</td>
<td>.08</td>
<td>.05</td>
<td>.50</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>5. Parent investment in technological capability</td>
<td>.10</td>
<td>.04</td>
<td>.13</td>
<td>.13</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>6. Investment irreversibility</td>
<td>.05</td>
<td>-.01</td>
<td>.07</td>
<td>-.23</td>
<td>-.22</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>7. Market size</td>
<td>.01</td>
<td>.03</td>
<td>-.00</td>
<td>-.00</td>
<td>.00</td>
<td>.00</td>
<td></td>
<td></td>
</tr>
<tr>
<td>8. Market growth</td>
<td>.02</td>
<td>.03</td>
<td>-.00</td>
<td>-.00</td>
<td>-.00</td>
<td>.00</td>
<td>-.16</td>
<td></td>
</tr>
<tr>
<td>9. Exchange rate volatility</td>
<td>-.09</td>
<td>-.14</td>
<td>-.00</td>
<td>-.00</td>
<td>-.00</td>
<td>-.00</td>
<td>.38</td>
<td>-.23**</td>
</tr>
</tbody>
</table>

N=1806 refers to the number of observations used in the other clusters sub-sample analyses.

\* \(p < .05\)

\** \(p < .01\)
cultural cluster of Korean electronics firms’ home country ($p < .05$), providing support for H1a.

Table 5 shows the results for Models 5 and 6. Inward-JV experience gained through partners from countries outside of the cultural cluster of the firm’s home country is not significantly related to the probability of initial investment in focal host countries culturally dissimilar to the home country. This indicates that the positive effect of inward-JV experience weakened when the firm entered a host country culturally dissimilar to its home country, providing support for H1b.1

The results for Models 3–6 for Hypotheses 2a and 2b (H2a and H2b) indicate that outward-FDI experience significantly increased the probability of initial investment ($p < .01$ for models 3 and 4; $p < .001$ for models 5 and 6). That is, outward-FDI experience gained in host countries culturally similar to the focal host country facilitated entry into the focal host country regardless of the cultural similarity between home and the focal host country. These result support for H2a and 2b. In addition, the results of the log-likelihood ratio test of the MMEL model versus the simple logit model provide support for this study’s choice of multilevel modeling that allowed for country-level heterogeneity.

A robustness check test was conducted using a sub-sample of the home country cluster after excluding China from the home country’s cluster. The results in Table 6 indicate that predictions of H1a and H1b are robust even with China excluded.

5. Discussion

5.1. Theoretical and empirical contributions

This study’s two main objectives are to (1) develop a theoretical framework for identifying boundary conditions for the effects of inward/outward experience and (2) empirically test boundary conditions for these effects in the context of initial investment, because MNCs may not benefit from prior experience without opportunities to transfer experiential knowledge across national and/or cultural boundaries. The results based on Korean electronics firms’ initial investment as an empirical context suggest that MNCs with prior related experience can benefit from their experience even in the case of their initial entry. In particular,
they can employ their inward-JV experience with foreign partners from countries culturally similar to the focal host country or their outward-FDI experience gained in countries culturally similar to the focal host country. The results provide support for the hypotheses about effects of inward/outward experience.

This study makes two major contributions to the international strategy literature. First, the theoretical framework suggested in this study can fill an important gap in the literature by addressing the situation in which MNCs may have no effective ways to reduce cultural uncertainty based on country-specific prior experience because initial investment represents a lack of existing experiential knowledge in the focal host country. If MNCs consider opportunities to transfer indirect experiential knowledge gained in the domestic market (through inward-JV experience) or direct knowledge gained in other host countries (through outward-FDI experience) to the focal host country, then they can alternatively reduce cultural uncertainty without having prior host-country-specific experience. Second, to our knowledge, this study is one of few pioneering empirical efforts to test the effects of inward-JV experience on the probability of initial investment, although previous studies have examined the effects of domestic-JV experience (i.e., JV experience with domestic partners) on cross-border JV survival (e.g., Barkema et al., 1996). The empirical results based on Korean electronics firms provide MNC managers with practical insights into the important role played by inward experience in future outward-FDI entry. Korean electronics firms have traditionally built their technological capabilities by playing supplier and buyer roles for MNCs in developed economies (Kim, 1997). At the same time, they have expanded the scope of their markets by serving local markets in both developed and developing economies (Chang & Rhee, 2011; Kim et al., 2010). In this sense, MNC managers in emerging economies can learn from Korean MNCs in the electronics industry. That is, they can gain basic foreign-market knowledge in their home markets by collaborating with foreign partners (Siegel, 2007). Such foreign partners can help them recognize the importance of cultural differences in foreign-market entry with respect to customers’ preferences, government officials’ behaviors, competitors’ behavioral patterns, and business partners’ trust in others (Cartwright & Cooper, 1993).

### 5.2. Managerial implications

Based on our findings, this study can propose several implications that are relevant to managers whose firms are

| Table 5 |
|---|---|---|
| Variables | Logit model (Model 5) | MMEL model (Model 6) |
| | Coefficient (z-value) | Coefficient (z-value) |
| Control variables | | |
| Firm size | 0.60 (6.52)** | 1.01 (7.25)** |
| Parent investment in marketing capability | 0.17 (0.78) | 0.22 (0.80) |
| Parent investment in technological capability | 0.31 (2.96)** | 0.32 (2.40) |
| Investment irreversibility | 0.01 (1.32) | 0.01 (1.09) |
| Market size | – | 20.25 (5.15)** |
| Market growth | – | 0.06 (0.44) |
| Exchange rate volatility | – | –0.01 (–1.57) |
| Independent variables | | |
| Inward Experience (H1b) | –0.28 (–0.67) | –0.15 (–0.24) |
| Outward Experience (H2) | 3.01 (9.97)** | 3.67 (8.70)** |
| Chi-Square | 379.42 | 134.85 |
| Prob. > Chi-Square | .0000 | .0000 |
| Likelihood ratio test vs. Logit model (Prob. > Chi-Square) | .0000 | |
| Number of observations | 1806 | 1806 |
| p < .05. | | |
| **p < .01. | | |
| ***p < .001. | | |

| Table 6 |
|---|---|---|
| Variables | Logit model (Model 7) | MMEL model (Model 8) |
| | Coefficient (z-value) | Coefficient (z-value) |
| Control variables | | |
| Firm size | 0.57 (5.28)** | 0.61 (5.40)** |
| Parent investment in marketing capability | –0.26 (–1.19) | –0.28 (–1.24) |
| Parent investment in technological capability | 0.20 (1.52) | 0.22 (1.59) |
| Investment irreversibility | 0.00 (0.27) | 0.00 (0.28) |
| Market size | – | 4.79 (1.09) |
| Market growth | – | –0.12 (–1.46) |
| Exchange rate volatility | – | –0.01 (–1.25) |
| Independent variables | | |
| Inward experience (H1a) | 0.67 (2.06)* | 0.73 (2.15) |
| Outward experience (H2) | 2.07 (2.00) | 2.13 (2.04) |
| Chi-Square | 77.00 | 55.63 |
| Prob. > Chi-Square | .0000 | .0000 |
| Likelihood ratio test vs. Logit model (Prob. > Chi-Square) | .0233 | |
| Number of observations | 378 | 378 |
| p < .05. | | |
| * p < .01. | | |
| **p < .001. | | |

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expanding into a host country for the first time. First, consistent with the notion of experiential learning, prior related experience matters when a firm decides whether or not it is going to enter a particular host country because prior related experience would reduce the level of uncertainty perceived by the firm’s managers in the country. Second, types of prior related experience matter because MNC managers are likely to perceive general and direct experience gained through inward FDI experience will be fungible across cultural boundaries for their future foreign market entry decisions, while task-specific and indirect experience gained through inward JV experience will be fungible only within a cultural boundary. Third, despite limited fungibility of inward JV experience gained outside the home country’s cultural boundary, a firm in its earlier stage of international expansion has a good reason to form JVs with partners from a foreign country which is strategically important market for it. By doing so, its managers can reduce uncertainties that they perceive in the country for their future expansions.

5.3. Limitations and future research

This study has several limitations that should be addressed in future research. First, the relative importance of the effect of country-specific experience with respect to that of third-country experience within a cultural cluster was not examined because it was not the primary focus of this study. In this regard, future research should examine the importance of national boundaries in transferring experiential knowledge within a cultural cluster. This research opportunity would be important because several international strategy studies have posited that the way of doing business in a country should be kept strictly within each country’s national boundary (Ghemawat, 2001). For example, future research may compare the relationship between institutional distance and the likelihood of initial investment within the cultural cluster of the home country relative to that outside the home country.

Second, because of a lack of data on each case of FDI entry, this study did not control for sales destinations of each initial investment. If the given entry focuses mainly on the local market of the host country, then its importance in reducing cultural uncertainty is greater than the initial investment focusing mainly on markets in other countries through exports from the focal host country (Luo & Tung, 2007). In this study, it is implicitly assumed that reducing cultural uncertainty would be equally important across focal host countries because MNCs would want to gain knowledge of the local market in each country they enter. In this regard, future research should employ detailed information on sales of foreign subsidiaries to validate this assumption.

Finally, future research should examine the roles played strategic planning in determining the level of learning from inward-JV experience. In the sample, Korean electronics firms with inward-JV experience might not have necessarily planned the transfer of experience gained through partnerships to their future foreign-market entry in advance. That is, they may have built inward-JV relationships with foreign partners simply for their domestic markets. However, even those firms with no deliberate learning plans can access learning opportunities through cross-cultural interactions with foreign partners. Therefore, firms that proactively pursue both inward and outward activities may benefit more from their ambidexterity than those that focus only on either foreign markets or the domestic ones.

6. Conclusions

Both firm-level experience and country-level institutional differences matter in MNCs’ international expansion process, particularly when they decide to enter a host country for the first time (Chang, 1995; Ghemawat, 2001, 2003; Johnson & Vahlne, 1977, 2009). However, the conditions under which some type of experience matters more than another in the context of initial investment remain unclear. This study fills the gap by classifying both the type of prior experience (inward vs. outward) and that of cultural boundary (within the home country’s cultural cluster vs. outside the cluster) that affect the applicability of prior experiential knowledge. Here the core argument may be more powerful in explaining initial investment by MNCs from emerging economies that possess no broad range of prior FDI experience.

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