

Cultural Distance of Nations and Localization Strategy of MNEs in China

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Abstract

This study explores the relationship between cultural distance of nations and the localization of MNEs in China. The empirical setting for this study was drawn from a multiyear sample of MNEs in the Chinese market. The data for the degree of localization of MNEs was drawn from an annual index provided by the China Entrepreneur magazine from 2010 to 2012. Hofstede's six cultural dimensions were employed to measure the cultural distance between the home and the host countries. The research question presented in this study was tested using a multiple regression model that used the localization of the MNEs as the dependent variable. The results indicate that the difference in the power distance between the home country and the host country has a positive relationship with the localization of the MNEs in the Chinese market. On the other hand, the other five dimensions of national culture do not present any significant relationships with the localization of the MNEs. The results are in agreement with arguments made in previous studies by indicating that the effects of national culture on the localization of MNEs are not the same under all circumstances but rather vary according to the different countries and to different chronological changes. Therefore, the MNEs should consider the cultural distance between the home country and the host country whenever deciding their strategy for internationalization, particularly in terms of the degree of localization for each target country.

Keywords: China, Localization, Multinational Enterprises (MNEs), National Culture

1. Introduction

The management practices and market performance of Multinational Enterprises (MNEs) are strongly influenced by the perceived risks and benefits inherent to the target market¹, and this perception is influenced by the cultural distance between the home market and the target market². Therefore, it is particularly important for MNEs to understand the national culture of the target market.

When the cultural distance between the home country and the host country is great, the impact of the national

culture on international management becomes even more important. Indeed, a high cultural distance between the host and the home country increases the costs of adaptation, performance monitoring, and transfer of strategic resources³. Thus, the cultural distance increases the uncertainty and risk levels perceived by executives with respect to the success of their cross-border operations⁴.

Hoskisson et al⁵ suggested that "emerging markets in general are economically fast-growing but structurally volatile, as they run the course of economic liberalization and transformation." Economic growth and liberalization offer remarkable new business opportunities for MNEs,

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but markets or politics in transition and transformation are accompanied by structural uncertainties and regulatory risks⁶. Localization helps MNEs become competitive in emerging markets by bringing costs closer to the lower level of those of local firms and therefore reducing the cost advantage of domestic companies. Furthermore, it also brings a better understanding of the local market and improves customer relationships.

However, a review of the literature of the impact that cultural distance has on the strategies of MNEs reveals that there is an inconsistency in the empirical findings presented by various researchers. For example, Ojala and Tyrvaäinen⁷ report that cultural distance has a significant impact on an MNE's international strategy, but Mitra and Golder⁸ report that cultural distance has an insignificant impact. Therefore, the debate on whether cultural distance has an impact on the international strategy of SMEs is still open. The present study investigates this issue and, specifically, seeks to examine the relationships between the cultural distance of nations and the localization of MNEs in the Chinese market.

Since the 1980s, China has become one of the most popular destinations for foreign direct investment (FDI). Although the large, traditional economies were dragged into a severe recession, China, as a new emerging economy, proved to be much more resilient against this financial storm⁹. China showed relatively strong growth throughout the crisis in 2009 and 2010. In a way, China has become an oasis for many MNEs in the midst of the downturn. In fact, many companies have opted for the Chinese market as major solution to overcome the current difficult times.

In addition to the increase in strategic importance that companies give to the Chinese market, many companies have also been observed to adjust their strategies in order to improve their performance. Indeed, the Chinese market has always presented significant challenges to MNEs. For example, cultural distance, distinct consumer behavior, and various institutional factors can be obstacles for the success of MNEs in this market. As a result, management localization has been suggested to be one of the solutions to address these challenges. Accordingly, many researchers have argued that MNEs in Chinese market should intensify the localization of their management practices in order to improve their local responsiveness. However, such a claim has not been proven empirically.

The rest of this article is organized as follows. The second section summarizes a review of the literature.

The third section discusses the data used and the method of analysis. The fourth section presents the empirical results of the analysis. The fifth section concludes with a discussion of implications for practitioners and researchers of managerial strategy.

2. Literature Review

2.2 Culture

Culture is defined as the collective programming of the mind that distinguishes members of one group or category from members of others¹⁰. It consists of the unwritten rules of the social game and is always a collective phenomenon because it is at least partly shared with people who live within the same social environment within which it was learned.

Hofstede's theory of cultural dimensions is considered to be a framework for cross-cultural communication. This theory describes the effects that culture has on the values of the members of a society as well as how these values relate to the behavior that these individuals express. The theory has been extensively used in several fields as a paradigm for research, particularly in cross-cultural psychology, international management, and cross-cultural communication. The theory was one of the first that could offer a quantified framework, and it could therefore be used to explain differences observed between cultures.

The original theory proposed four dimensions along which cultural values could be analyzed: individualism-collectivism; uncertainty avoidance; power distance (strength of social hierarchy) and masculinity-femininity (task orientation versus person-orientation)¹¹. Individualism is defined as a preference for a loosely-knit social framework in which individuals are expected to only take care of themselves and their immediate families. Its opposite, collectivism, represents a preference for a tightly-knit framework in society in which individuals can expect their relatives, or members of a particular in-group, to look after them in exchange for unquestioning loyalty. A society's position on this dimension is reflected in whether people's self-image is defined in terms of "I" or "we".

The uncertainty avoidance dimension expresses the degree to which the members of a society feel uncomfortable with uncertainty and ambiguity. The fundamental issue here is to define how a society deals

with the fact that the future can never be known. In other words, should we try to control the future, or should we just let it happen? Countries that exhibit strong uncertainty avoidance maintain rigid codes of belief and behavior and are intolerant of unorthodox behavior and ideas. Weak uncertainty avoidance societies maintain a more relaxed attitude in which practice counts more than principles.

The power distance dimension expresses the degree to which less powerful members of a society accept and expect for power to be unequally distributed. The fundamental issue here is how a society handles inequalities among people. People in societies that exhibit a large power distance accept a hierarchical order in which everybody has a place and no further justification is needed. In societies with a low power distance, people strive to equalize the distribution of power and demand a justification for power inequalities.

With respect to the masculinity versus femininity dimension, the masculinity side represents a preference in society for achievement, heroism, assertiveness, and material rewards for success, and as a result, society at large is more competitive. Femininity, on the other hand, indicates a preference for cooperation, modesty, and caring for the weak and for quality of life. In this case, society at large is more consensus-oriented.

In 1991, Michael Bond conducted an international study in which a survey targeting students was implemented, and as a result, a fifth dimension, long-term orientation, was added¹². Long-term orientation can be interpreted as a concern in society's search for virtue. Societies with a short-term orientation generally have a strong concern for establishing the absolute truth. They are normative in their thinking and exhibit great respect for traditions, a relatively small propensity to save for the future, and a focus on achieving quick results. In societies with a long-term orientation, people believe that truth depends very much on situation, context, and time. They show an ability to adapt traditions to a change in conditions, a strong propensity to save and invest thriftiness, and perseverance in achieving results.

Finally, in the 2010 edition of *Cultures and Organizations: Software of the Mind*, Hofstede and co-author Michael Minkov added a sixth dimension, indulgence versus self-restraint¹³. Indulgence indicates that a society allows relatively free gratification of basic and natural human drives related to enjoyment of life and

having fun. Restraint indicates that a society suppresses gratification of needs and regulates these through a means of strict social norms.

2.2 Influence of Cultural Distance to MNEs

Cultural distance refers to an aggregation of the cultural differences between different countries¹⁴. The differences in national culture are defined through distinctive, continuous, non-materiality measures between each country's language, tradition, disposition, and life style. The difference in the cultural context of the nation is not the only sources of the origins of cultural differences. Each company has an "enterprise culture" and the individual staff has their own as well, and these are also an important origin of cultural distance¹⁵. An MNE that is in the process internationalization development faces a multiplex cultural environment. The cultural distance will produce positive influence and a negative influence on the enterprise development¹⁶. In terms of the negative aspect, the cultural distance will cause cultural conflicts and will also affect the realization of business goals while hindering the development of the MNEs and decreasing their chance of survival.

The business management process itself is a form of communication. Independently of the execution of a management system or of the implementation of decisions targeting specific goals, if communication is not smooth, it will be impossible for an enterprise to achieve its goals. When engaging in communication, the difference in the cultural context for both sides will often increase the difficulty of and barriers to communication¹⁷. With respect to internal management, the staff of an MNE will have differences in terms of their motivation, demands, and expectations for their jobs, so they will also have different needs in terms of communication, motivation, leadership, and control exerted by the firm. This causes management activities to become very complex¹⁸. With respect to external management, the conflicts in terms of values, language, manners, and customs will require for the enterprise to develop their practices to suit their environment, increasing complexity and, thus, management difficulty.

The policy-making members of an MNE often come from countries that have different cultures and form their personal opinion according to their values. Thus, they need a certain amount of time to eliminate cultural

conflicts¹⁹. If a policy-maker comes from a country with a different culture, then he/she will be more likely to neglect the importance of other cultural values and core beliefs and can thus commit an error in judgment. When the staff and management of an MNE have differences in terms of their behavior, adverse consequences will result for the MNEs' internal management and exterior operations²⁰. For internal management, differences in staff behavior will create misunderstandings that will result in an increased difficulty for internal coordination, and the operating efficiency will be low. For exterior operations, the internal differences in the staff will cause the company to fail to be competitive in the market by performing as one cohesive unit, and can even lose market share to their competitors.

2.3 Globalization vs. Localization

A firm's perception of the risk-return tradeoff drives the strategic management of their international operations²¹. According to Papadopoulos et al²², managers must consider both the "pluses" and "minuses" – commonly expressed in the literature as tradeoffs between "opportunities and risks," "costs and benefits," or "cost and control"²³ – when formulating their international management strategies.

From this perspective, the cultural distance argument leads to a discussion of globalization (standardization) and localization (adaptation) in the international management of MNEs as a driving factor for the tradeoffs in a relationship²⁴. In general, MNEs have two options that depend upon the similarity and dissimilarity of a local culture: globalization and localization²⁵. Globalization will be beneficial when the culture of the target market is similar to the national culture of the MNE whereas localization is preferred when the national culture of the target market is considerably different from its own²⁶.

Proponents of globalization argue that a common strategy can be sufficient across national boundaries due to shared universalities around the world²⁷. The basic premise of this idea is that the business environment around the world is not significantly different²⁸. Accordingly, customers around the world tend to share the same needs and wants²⁹, and therefore a standardized approach allows international firms to build a consistent identity throughout the world and to considerably reduce media costs and production expenditures³⁰.

MNEs cooperate internally in order to implement a globalization strategy, and operations must be managed

in a suitable scale through strict organization with a scientific management system. However, cultural differences cause decision-makers and staff to behave differently, and thus they cannot form a unified body and create a slow reaction for MNEs. Therefore, it is not extremely favorable for MNEs to implement a globalization strategy³¹. Accordingly, supporters of a localization approach argue that different strategies across national boundaries would work more effectively because people's behavior differs across countries and cultures³². They argue that insurmountable differences exist between countries in terms of the cultural, economic, and legal conditions as well as the media availability, product-life cycle, and industry infrastructure³³. Therefore, these structural differences demand for adaptation or development of different strategies for different cultures. Since the 1990s, the concept of localization has become the dominant strategy among MNEs in some markets³⁴.

Thus, depending upon the similarity and dissimilarity of their culture as compared to that of the target country, MNEs have two options: globalization or localization. Globalization is used when the culture of a target market is similar to the national culture of the MNE whereas localization is preferred when the national culture of a target market is considerably different³⁵.

3. Methodology

The empirical setting for this study was drawn from a multiyear sample of MNEs in the Chinese market. China has been characterized by rapid economic growth and by the presence of a highly competitive market. Moreover, rapid economic growth should continue to fuel the growth of market-seeking FDI inflows to the region. According to the World Investment Report³⁶, FDI flows into Asia and the Pacific soared rapidly in 2007. The top four recipients were China, Hong Kong, Singapore, and India, in that order.

The data for the localization of MNEs was drawn from the annual index of the China Entrepreneur magazine from 2010 to 2012. In line with other studies on cultural distance³⁷, the current study conceptualizes cultural distance as the difference in national cultural values between the home and the host country. Although some scholars have used different conceptualizations of national culture³⁸, Hofstede's research³⁹ represents the most popular and widely used empirically-based

dimensions of national culture. Thus, in this study, the average score of the differences in Hofstede's six cultural dimensions was adopted in order to measure national cultural distance between the home and the host country.

The firm age, measured as the number of years since the MNEs was founded in China was controlled. The type of industry, coded as "0" for a firm in the manufacturing industry and "1" for a firm in the service industry, was also controlled. In addition, firm size, measured as the number of employees, was controlled because it has been

identified in various studies as a factor that impacts the strategic choices of firms⁴⁰.

The research question presented in this study was tested using a multiple regression model with the localization of MNEs as the dependent variable.

4. Result

Table 1 presents the descriptive statistics and the Pearson's correlations matrix.

Table 1. Descriptive Statistics and Correlations

Variables	Mean	S.D.	1	2	3	4	5	6	7	8	9
1. Localization	20.50	2.85									
2. Firm Age	19.51	7.63	0.14*								
3. Type of Industry	0.30	0.46	-0.14*	-0.11							
4. Firm Size	402	445	0.17**	0.08	0.10						
5. Difference for PDI	34.63	12.06	0.15**	0.10	0.21**	0.05					
6. Difference for IDV	54.72	22.69	0.04	0.12*	0.21**	0.03	0.40**				
7. Difference for MAS	13.71	16.37	-0.01	0.06	-0.12*	-0.06	-0.18**	-0.34**			
8. Difference for UAI	28.93	18.71	-0.07	-0.01	-0.24**	0.01	-0.65**	-0.60**	0.32**		
9. Difference for LTO	35.65	24.27	0.05	-0.02	0.24**	0.01	0.34**	0.61**	-0.34**	-0.69**	
10. Difference for IND	33.88	13.71	0.07	0.12*	0.23**	0.01	0.58**	0.65**	-0.08	-0.73**	0.72**

* $<.05$; ** $<.001$, $N=300$

A review of the correlations between the independent variables indicates that inter-correlations among some of the cultural distance variables are high. Therefore each of the cultural distance variables was mean-centered in order to remedy the possibility of multicollinearity⁴¹. Variable centering is well known to reduce multicollinearity between predictor variables as well as to often increase the interpretability of the regression coefficients⁴². In order to check for the independence of the predictor variables, the Variance Inflation Factors (VIF) were analyzed. We found 4.139 to be the highest value for the VIF, and thereby conclude that multicollinearity was not a problem for these analyses.

Table 2 presents the results of the regression analysis. It indicates that the distance for difference of power between the home country and China has a positive relation with the localization of the MNEs in Chinese market. Thus, when controlling for organizational factors, the degree to which the inequality among people is considered to be normal in the home country of the MNE affects the localization of the MNEs in China. However, the other

five dimensions of national culture (individualism versus collectivism, masculinity versus femininity, uncertainty avoidance, long-term versus short-term orientation, and indulgence versus restraint) do not have any significant relationships with the localization of MNEs in China.

Table 2. Results for Regression Analysis

Variable	Regression Coefficient (T-test Results)	VIF
Firm Age	0.096 (1.65)*	1.091
Type of Industry	-0.183 (-3.096)**	1.116
Firm Size	0.167 (2.944)**	1.028
Difference for PDI	0.203 (2.465)**	2.216
Difference for IDV	-0.023 (-0.282)	2.138
Difference for MAS	0.022 (0.330)	1.478
Difference for UAI	0.037 (0.357)	3.486
Difference for LTO	0.107 (1.065)	3.208
Difference for IND	-0.052 (-0.455)	4.139
R ²	0.094	
F-statistic	3.348***	

* $<.10$; ** $<.05$

In terms of the control variables, a significant positive relationship was observed between the firm age and the localization of the MNEs. Hence, it appears that older MNEs tend to be characterized by strategic profiles that remain similar to those of local firms in their industry. On the other hand, the type of industry was shown to be negatively and significantly related to the localization of MNEs. This means that MNEs in the manufacturing industry were more likely adopt a localization strategy than MNEs in the service industry in the Chinese market. Table 2 also reports a significant positive relationship ($p < .05$) between firm size and localization for MNEs, implying that a larger MNE more actively adopts a localization strategy.

5. Conclusion

Many of the studies that discuss cultural distance and the international strategy of MNEs have been conducted in developed countries while few studies have focused on MNE activities in developing countries⁴³. Given that the international expansion of MNEs to developing countries is a more recent phenomenon than that of MNEs to developed countries and that the two sets of firms have generally grown under different business and economic environments, with access to different pools of resources, it is important to study the impact of cultural distance on the international strategy of MNEs in developing countries⁴⁴.

This study addresses this gap in the literature by analyzing a multiyear data set of MNEs in the Chinese market. The findings offer an improved understanding of the effects of cultural distance on the localization of MNEs in China. They indicate that the effects of national culture on the localization of MNEs are not the same in all circumstances⁴⁵ but vary across different countries and chronological conditions. Thus, international strategies that are effective in one cultural context may be ineffective in another. Therefore, MNEs should consider the cultural distance between the home country and the host country whenever they are deciding for their internationalization strategies, specifically with respect to the degree of localization for each target country.

Given the increasingly global nature of business, the findings of this study should also be of significance to any company that is considering an engagement in a joint venture, acquisition, or other business activities in other countries. Also, this study makes a contribution

to research in the field as well as to contemporary management practices by directly addressing the subject as to how MNEs actually manage their subsidiaries in emerging countries, a subject that has been much ignored in previous studies.

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7. References

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