An analysis of cultural impact on international business performance via foreign market entry mode: case of South Korean MNCs

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ABSTRACT

Research on the entry mode of multinational companies (MNCs) to a new market has been one of the major topics in the international business, and the cultural factor has been regarded as one of the major factors to explain the entry mode selection of MNCs. Based on the development on the cultural factors on entry mode, MNCs can enter a market with joint venture or a wholly owned subsidiary. This study tries to extend the analysis on the cultural factor by investigating whether a MNC prefer a new establishment of business or an acquisition of an existing local firm when the MNC enters the market with a wholly owned subsidiary. Also this study tests whether a MNE with more global experience has been less affected by cultural difference from a target market.

The results from the empirical analysis on the first hypothesis show that a MNC prefers a new establishment of business when it enters a market as a wholly owned subsidiary. The second hypothesis is rejected with the empirical tests, and impact of cultural difference on performance of a MNC is not affected by the level of global experience of the MNC.

Keywords: International Business, Cross-Cultural Management, Foreign Entry Mode, Foreign Direct Investment, Cultural Difference, MNE

INTRODUCTION

Foreign direct investment has been one of the most important subjects in International Business (Javetski, Edmondson and Echikson, 1996), and choosing the right foreign market entry mode will determine the success of foreign direct investment (Geringer, Beamish and deCosta, 1989). While traditional approaches to explain the market entry strategies of multinational enterprises (MNEs) use the economic and management factors, recent studies have found the strong effects of cultural factors on foreign market entry strategies.

Most studies on cultural effects have been made on strategic alliance and joint ventures with various factors such as credibility between partners (Parkhe, 1993; Tiessen, 1997; Tyler and Steensma, 1998, Weaver et al., 2000), cultural difference and control levels (Kogut and Singh, 1988; Erramilli and Rao, 1993; Padmanabhan and Cho,1996; Annad and Delios, 1997), and ownership structure of foreign subsidiaries (Erramilli, 1996; Hennart, 1998).

With the use of various factors described above, most studies on cultural factors have been made on the form of strategic alliance between joint ventures and fully owned subsidiaries. Some studies proved that the joint venture investment is desirable strategy of foreign market entry mode with more cultural differences (Kogut and Singh, 1988; Gatignon and Anderson, 1988; Erramilli and Rao, 1993). Other studies argued that wholly owned subsidiary is the best way to enter a foreign market when there exists large cultural differences (Shane, 1994; Padmanabhan and Cho, 1996; Erramilli, Agarwal and Kim, 1997).

However, few studies have been done whether a firm needs to open a new subsidiary or acquire an existing local company when the firm enters a foreign market with the strategy of fully owned subsidiary as entry mode. Also, dynamics of cultural factors on foreign market entry mode can be investigated by asking whether cultural difference can make a less impact on the performance of a MNE with more global business experience. This study will use the Korean MNEs data to answer these two questions.

LITERATURE REVIEW AND HYPOTHESES

For the success of strategic alliance in foreign direct investment, it is critical to maintain reliable partnership and minimize risks from any opportunistic behaviors (Larson, 1991). Higher level of trustworthiness between joint ventures is required to obtain these critical factors. Different cultures have different levels of trustworthiness, and cultural difference needs to be used to measure the different level of trustworthiness among different countries.

One of the ways to measure cultural difference is four cultural dimensions by Hofstede (1980). Masculinity will negatively affect the joint venture projects, and individualism will make negative impacts on the voluntary joint management of a firm (Tiessen, 1997). Power distance can be used to measure the level of control of joint venture company, and uncertainty avoidance can promote more joint venture projects in foreign direct investment (Hofstede, 1980).

Cultural difference of countries can be a factor to determine the type of wholly owned subsidiary investment. Larger difference in culture requires stronger controls of business, and firms will prefer wholly owned subsidiary as an entry mode to foreign markets. To fully own a foreign firm, a firm can establish a new business or acquire an existing firm in the target market. Morosini (1998) argues that the cultural difference will increase the benefit from acquiring an existing firm in a new market, since the MNE can learn the different norms and routines on the

target country from the acquired subsidiary. Jemoson and Sitkin (1980) and Hofstede (1980) show the similar results.

Meanwhile, Klein, Frazier and Roth (1990), and Sutcliffe and Zaheer (1998) suggest that MNEs will establish a new venture when they enter a new market with larger cultural difference to have higher level of control to fully utilize its superior knowledge and experience on its products. It also wants to minimize risks and costs to coordinate management and business from the different cultures. From the above discussion, the following hypothesis is introduced.

Hypothesis 1: A MNE prefer establishing a new investment on a wholly owned subsidiary when it faces larger cultural distance in the new market.

If a MNE becomes more internationalized, cultural difference will have less impact on the performance of business in a new market. There are three effects to explain this relationship. First, a MNE is more internationalized, it will possess more experience and knowledge on international business environments and higher understanding on unique cultures of other markets. This will reduce the uncertainty from the cultural difference. Second, when a MNE is more globalized, the organization of the MNE is also globalized. The decisions from the globalized organization will be more flexible and consider the cultural difference of foreign investment. Third, as a MNE is performing more global investment projects, it will accumulate various strategies on issues from the cultural difference, and increase its internal strength of dealing with those cultural issues. Therefore, these three factors can be summarized as the following hypothesis.

Hypothesis 2: As a MNE becomes more globalized, the effect of cultural distance on the performance of the MNE is diminished.

EMPIRICAL ANALYSIS AND RESULTS

Data

"Directory of Overseas Markets Investing Companies" by Korea International Trade Association has been used to make the list of Korean firms with overseas investments. The randomly selected 320 companies from the directory are surveyed. Out of 320 companies, 106 replied the surveys, and the 13 companies out of replied companies are discarded due to the inappropriate answers for the empirical analysis.

Table 1 and 2 in Appendix describe the distributions of industries and regions on the sample. The distribution of industries and regions from these companies show the similar distributions on the entire industries in Korea, stating the proper representation of the sample to the population.

MEASUREMENTS OF VARIABLES AND TEST OF HYPOTHESIS

Measurements of Variables

The difference of culture between the home country and the target country is used to define distance on national culture. To measure the cultural distance, this study follows the four

factor measure by Hofstede (1980): power distance, uncertainty avoidance, masculinity, and individualism. Based on these four factors, the detailed measurements are developed to make survey questions.

Cronbach's Alpha test has been made to measure the reliability of those factors. The result of Cronbach test makes the masculinity factor removed from the following empirical analysis, since the reliability for masculinity has the value of .476.

Test of Hypothesis 1

To test the hypothesis 1, logistic regression analysis is used. The hypothesis 1 indicates that a firm will prefer the establishment of a new subsidiary when the firm enters a foreign market with the wholly owned subsidiary. A new establishment of business is assigned to 1, and the acquisition of an existing firm 0. The results are summarized in Table 3 (Appendix). Cultural distance is measured by power distance, uncertainty avoidance, and individualism.

Chi-squared statistics shows that the goodness of fit of the model is acceptable within the 5% significance level, whereas percentage of correct is not high. Beta coefficients on power distance and uncertainty avoidance indicate that a firm prefers a new establishment with more cultural distance described by power distance or uncertainty avoidance. Individualism as one of the factors of cultural distance has negative relationship with the strategy of a new wholly owned subsidiary, but it is less statistically significant than other two variables. Based on the analysis, the hypothesis 1 is accepted.

Test of Hypothesis 2

Moderated multiple regression is used to test the hypothesis 2. The hypothesis 2 analyzes how the globalization level of a MNE affects the magnitude of impact of cultural distance on the performance of the firm. To test if the globalization level becomes the moderator variable, this study estimates the following model.

$$Y = \alpha_1 + \beta_1 X_1 + \varepsilon_1$$
$$Y = \alpha_2 + \beta_2 X_2 + \varepsilon_2$$
$$Y = \alpha_3 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_1 X_3 + \varepsilon_2$$

Y is performance of a firm, and X_1 measures cultural distance. X_2 is globalization level measure. To make the globalization level variable a moderator variable for the impact of cultural distance on performance, β_2 needs to be zero, and β_3 has to have non-zero value. The results of the regression analysis on the above model are summarized in the Table 4 (Appendix).

All three models maintain good F-statistics with 5% significance level, and R-squared values are relatively low. The survey of satisfactory level on the performance of overseas subsidiaries is used to measure performance in the above estimations.

The interactions of globalization level and the other three factors of cultural distance show negative evidence on the hypothesis 2, since they are not significant explanatory variables in the models. Also the globalization level as a separate explanatory variable in the models cannot produce any significant explanatory power. Based on the results of empirical analysis, the hypothesis 2 is rejected.

CONCLUSION

Cultural difference between two countries plays an important role in the international business. Especially, when a MNE enters a new market, cultural distance based on cultural difference will determine a proper entry mode into the market. Since the entry mode is crucial for the success of a new business in the overseas market, various studies have been made on the relationship between cultural distance and entry mode in the foreign market such as joint venture and wholly owned subsidiaries.

This study tries to go further in testing two hypotheses. The first hypothesis is that when a firm wants to invest in a foreign market as a wholly owned subsidiary, the firm will prefer a new establishment of business instead of acquiring an existing local firm to gain full controls of its business and minimize any uncertainty from the acquired local firm. Based on the empirical tests with logistic model, the hypothesis 1 is accepted.

The second hypothesis focuses on the relationship between performance of a MNE and the cultural distance when the firm has different level of globalization. The hypothesis assumes that with higher level of globalization, a MNE's performance will be affected less from the same cultural distance. The impact of cultural distance on the performance becomes diminished when a MNE has more experience from its international business.

The test of the hypothesis is made by the use of moderated multiple regression with the moderator variable of globalization level. The test results reject the hypothesis, and the globalization level of a MNE cannot change the effect of cultural distance on the performance of the firm.

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APPENDIX

Table 1: Industry distribution of sample companies

	Industry								Total
	Transportation/Construction	Finance	Chemistry/ Energy	Electric/ Electronic/ Machinery	Automobile/ Heavy Industry Automobile/ Heavy Industry	Food/ Pharmaceutical	Apparel/ Textile	Miscellaneous	Total
Frequency	10	8	8	23	10	12	14	8	93
Ratio (%)	10.8	8.6	8.6	24.7	10.8	12.9	15	8.6	100

Table 2: Regional distribution of sample companies

	Regions and Countries							Total
	U.S.A.	Europe	Japan	China	South America	Southeast Asia	Others	Total
Frequency	8	19	4	28	3	25	6	93
Ratio (%)	8.6	20.4	4.	0.1	.3	26.8	6.5	100

Table 3: Results of logistic regression on Hypothesis 1

Explanatory Variables	Beta Coefficient	S. E.	p-Value
Constant	.046		
Power Distance	.046	.213	.031*
Uncertainty Avoidance	.368	.245	.048*
Individualism	-.348	.253	.058

-2LogLikelihood = 89.325
Chi-squared = 19.30 ($p < .05$)
% Correct = 69.8%

Table 4: Results of moderated regression of globalization level on cultural distance impact

Explanatory Variables	Model 1		Model 2		Model 3	
	β	p-value	β	p-value	β	p-value
Power distance (PDI)	.460	.031*	.440	.036*	.474	.039*
Uncertainty avoidance (UAV)	.368	.048*	.298	.049*	.236	.042*
Individualism (IND)	-.348	.058	-.304	.236	.012	.123
Globalization level (GLO)			.054	.120	.054	.184
PDI * GLO					.022	.364
UAV * GLO					-.036	.236
IND * GLO					-.012	.475
F-statistic	3.276 (p<.05)		3.326 (p<.05)		3.174 (p<.05)	
R-squared	.223		.227		.256	