

The Role of Culture in FDI in the PRC: Implications for HR Practitioners, and Managers

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ABSTRACT

This paper examines the role that culture plays in Foreign Direct Investment (FDI) in the People's Republic of China (PRC). Using examples of inward FDI from mostly western Multinational Corporations (MNCs), the implication of Chinese culture, Transaction Cost Theory, and modes of entry are discussed. The authors suggest that the increase in, and the rate of direct FDI in the PRC (prior to the current worldwide economic crisis) raises important issues with respect to employment and talent management issues and organizations would be wise to consider the mode of entry and management practices if they are to be successful in China.

Keywords: Chinese Culture, Foreign Direct Investment (FDI), Guanxi, Guo Qing, Multinational Corporations (MNCs), People's Republic of China (PRC)

INTRODUCTION

Firms often face difficult choices regarding the location of Foreign Direct Investments (FDI). Motivations to invest in foreign countries include nations with favorable economic, institutional, and regulatory conditions. In addition, foreign firms may be attracted to certain host country cultural characteristics (Bhadwaj, Dietz, & Beamish, 2007). Cultural values underlie business practices (Hofstede, 2001). Culture has been defined as “a way of life, a conventional order, physically acquired and rooted in subliminal consciousness. The

rule of culture extends from the family, village or circle of social acquaintances to the tribe or nation” (Mazakazu, 1996). Hill (2005) suggests that culture is a system of values and norms that are shared by a group of people and that when taken together constitute a design for living (p. 91). Overall, the literature suggests that that Culture affects the firm's international business operations from selection of host country, to mode of entry, to its relations with government officials, to its operations in-country including the management of its workforce (Brewer & Sherriff, 2007).

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OBJECTIVE OF THIS PAPER

Building on prior research, the main goals of this paper are as follows:

1. Discuss the role of Culture in inward Chinese FDI
2. Highlight some challenges for western MNCs in operating in the PRC

Delimitations

1. Research on Culture is largely an American or European line of literature and as such, its relevance to business in countries that have not experienced the cultural distance of the US and EU (particularly northern EU) countries and the PRC is open to question (Brewer & Sherriff, 2007).

THEORETICAL FRAMEWORK

Geert Hofstede is among the most eminent scholars in cross-cultural research. His 5D model is still the currency by which many MNFs analyze entry risks, modes and level of investment in host countries. Hofstede's research occurred during his tenure at IBM where he had access to a large number of employees deployed around the world within the IBM enterprise. His research led to the development of a model of national cultural differences predicated on the following constructs: Power Distance, Individualism, Masculinity, Uncertainty Avoidance, and Long-Term Orientation (Hofstede, 2001). The importance of Hofstede's work, among other things, is that it demonstrates the existence of differences in values in some societies and in an international business context, these differences need to be carefully managed in order for an FDI to succeed

Power Distance refers to the extent to which societies accept that power is distributed unequally within organizations and society. People in these societies believe and accept that inequity is unavoidable (Hofstede, 2001).

Individualism(-Collectivism cultural dimension) refers to whether individual interests prevail in a society as compared to in-group membership and the belief that members take care of each other in exchange for loyalty.

Masculinity (-Femininity cultural dimension) refers to the emphasis of competition and survival of the fittest in business versus an emphasis on social welfare and the quality of life. Feminine societies stress equality, solidarity and consensus.

Uncertainty avoidance refers to comfort or discomfort people have with ambiguity. Low scoring countries accept uncertainty more readily than higher scoring countries.

Long-term orientation is just that. It should therefore come as no surprise that China, given its history and length of its civilization, is among the highest scoring, i.e. most long term oriented societies in the world.

Interesting enough a similar study, using these same dimensions on a data set known as the European Values Study was performed by Gulev (2006) compared the cultural-business relationship between Slovenian (host country) and Denmark, Germany and Austria (home countries). Their findings suggest direct linkages between capitalistic (high masculinity cultures like the US) and authoritarian economic cultures (high power distance cultures like China) on the managerial aspect of headquarter-subsidary relationships.

Transaction Cost Theory (Coase, 1937), while intuitive today, posits that firms will organize and direct their business in those markets where it is cheapest to perform. All costs are considered in the make-it or buy-it decision. When a market is competitively full, transaction cost theory assumes that the market will regulate transactions thorough price mechanisms. In an imperfect market, bringing together resources previously held by different firms incurs high transaction costs in the market for corporate control or in the host country for complementary assets. The process of internationalization involves the exploitation of a firm's competitive advantages by acquiring complementary assets (thereby reducing transaction costs) in foreign

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