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IMPACT OF CULTURAL DIFFERENCES ON INTERNATIONAL BUSINESS: A REVIEW OF LITERATURE

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ABSTRACT

The term cultural distance has come to occupy a very important place in international business. While culture conditions the norms and behavior of the people of a particular group the difference in this norms and behavior of people across different cultures has strong implications for international business negotiations. The underlying research attempts to understand the impact of cross border cultural differences on international business, to ascertain whether cultural distance asymmetry exists or not and whether the difference in the cultures across border provide any scope for positive impact on the business negotiations or not. An attempt has also been made to study the factors that influence the investment mode preferences of the different countries and to understand the role of language in international business. Based on the review of literature it has been found that cultural distance is the mixed blessing in case of international business since it can have both positive and negative impact. The research also revealed that cultural distance asymmetry exists that influences the investment preferences of the countries. Also the language has an influence on the pattern of foreign market expansion of the business firms. Overall it is important for the business firms to know the differences in the cultures of different countries so as to avoid extremely risky situations and prevent business failures on account of cultural distance.

KEYWORDS

Culture, Distance, International Business, Language.

JEL CODE

F20, F23.

INTRODUCTION

According to Ferraro, "Culture is everything that people have, think and do as a member of society". This definition highlights three important structural elements of the concept of culture i.e. a person must possess something (have) that makes him a part of a particular culture or he may think of certain ideas, values or may exhibit certain attitudes and beliefs that are unique to a particular culture (think) or behave in a manner that is prescribed by the society (do). All these three components give rise to different cultures that result in cultural differences (Ferraro, 2001).

Culture can also be defined as a set of shared values, assumptions and beliefs that can be learned out of the membership of the group that influences the attitudes and behaviors of the members of the group (Ghemawat & Reiche, 2011). This highlights the group phenomenon associated with culture and how culture distinguishes one group from another on the basis of the difference in the cultural norms and behavior. At the same time it also indicates that culture exists at various levels like organizations, industries, nations etc. Moreover culture is more associated with the process of socialization rather than with the birth. This is because the learning can take place in any phase of life and during any stage of the person's life cycle. Also it is the collective programming i.e. the cultural values that set the preferences and priorities in one's behavior (Ghemawat & Reiche, 2011).

Another important definition of culture has been given by Geert Hofstede as "the collective programming of the mind that distinguishes the members of one organization from others" (The Hofstede Centre, n.d.). The term collective programming implies a process that conditions the people of the group by the same education, religion, history, education, norms, values etc. Due to the difference in culture people of different cultures view the same problem differently. As a result people from different countries are different from each other because of the difference in their collective programming. As part of one of the most extensive study on culture Hofstede has conceptualized the culture on the basis of five dimensions which are individualism versus collectivism, power distance, masculinity versus femininity, uncertainty avoidance, long term orientation or Confucian dynamism (Ghemawat & Reiche, 2011).

With the increasing globalization and growing business transactions across nations, cultural differences have come to occupy an important place. The knowledge of the cultural differences has gained unprecedented importance because any misunderstanding on account of the values and norms can adversely affect the business negotiations. The knowledge of the cultural differences can help in avoiding the conflicts in international business negotiations.

The lack of knowledge about cultural differences can result in difficult and embarrassing situations. This can also impact the business relationships. This can be explained with the help of an incidence. An analysis of the conversations recorded in the black boxes of Korean Air's crashed planes to ascertain the reason behind high number of plane crashes during the period of 1970-2000 revealed that the co-pilots and flight engineers in all Korean cockpits were so deferential to their captains that they never thought of giving any suggestion that would contradict the judgment of the captain since it is culturally unacceptable behavior to challenge one's superior in Korea (Ghemawat & Reiche, 2011). A vast research in the area of Foreign Direct Investment indicates that culture plays a very important role in selecting the country and mode of entry for FDI. The knowledge of the cross border cultures can enable to nations to obtain business competencies and success in international business.

OBJECTIVES OF THE STUDY

The objective of the study is to understand the impact of cross border cultural differences on international business.

The purpose is also to know whether cultural distance asymmetry exists and how it affects investment preferences and to gain an insight whether cultural distance between two countries provides a scope for positive impact on international business or not.

The objective is also to understand how language influences the pattern of foreign market expansion and to ascertain the factors that influence the choice between various modes of entry in international business.

RESEARCH METHODOLOGY

The research is primarily based on the review of literature. The research papers related to the objectives of the present study have been studied thoroughly to gain an insight into the extent to which the cross cultural differences impact the international business.

LITERATURE REVIEW

Lamont & Reus (2009) provides an insight into the effects of the role of cultural distance in international acquisitions. They are of the view that cultural distance does not have direct effects on acquisition performance; rather it is likely to have indirect positive and negative effects that might cancel out each other in the aggregate. In order to understand the relationship between cultural distance and acquisition performance the role of integration capabilities has been referred which refer to organizational practices specific to managing the post-acquisition integration process.

The researchers hold that the negative effects of cultural distance on acquisition performance are likely to be mediated by its impeding effects on integration capabilities. On the other hand, making acquisitions in culturally distant countries is associated with an enriching effect on the application or use of existing integration capabilities namely understandability, communication, and key employee retention. It has been argued that complication arises on account of cultural distance being a source of hindrance in the development of integration capabilities. Cultural distance obstructs understandability because multinational companies are likely to have less knowledge of the local cultures and business practices in the local markets. Cultural distance also acts as a hindrance in communication that can adversely affect the acquisition performance. Similarly, key acquired employees may be less motivated to work for the new foreign parent. However an alternative view holds that understandability on account of distinct routines and practices, rich communication allowing cross cultural learning and the opportunities available to the key employees to learn diverse viewpoints because of the difference in the cultures can create synergic benefits for the two firms. In the study five characteristics of the acquirer were included as control variables namely industry differences, degree of internationalization of the acquirer prior to the acquisition, prior country experience of the acquirer, total number of acquisitions and past firm performance. In addition, they included four acquisition characteristics as control variables namely the business relatedness, relative size (i.e., the size of the target firm compared with the size of the acquiring firm), autonomy provision to the acquired firm and economic, financial, and political conditions that are likely to vary year by year.

The results confirmed a more interdependent perspective that views cultural distance as a mixed blessing, because while it may enhance the potential for learning when integration capabilities are in place, it also hinders the development of these integration capabilities. The findings indicate that the ''process view'' of acquisitions which emphasizes the role of integration capabilities, is relevant in understanding international acquisition performance. It was also found that international acquisition performance is in large part a function of the development and application of understandability, communication, and key employee retention during acquisition integration. The results confirm that there is no simple answer to the question whether acquirers will face poor or strong performance in distant cultures. However, a complicating factor in the role of cultural distance is that it also makes it more difficult to develop the context that fosters these integration capabilities. Thus the findings suggest that cultural distance is a double-edged sword with costs and benefits (Lamont & Reus, 2009).

Shenkar et al (2008) applied cultural familiarity theory to develop hypotheses pertaining to the relationships between the direction of investment flow, cultural distance, and control (as reflected in entry mode preferences). To disaggregate the confounded impact of a foreign environment and a foreign partner when seeking cross-border cooperation, inward and outward cooperative preferences of small and medium-sized Korean firms were examined simultaneously. Outward investment seeks a cooperative relationship in a foreign country in which the partner firm is operating. Cooperative domestic investment, on the other hand, seeks a cooperative relationship in the domestic market in which the focal firm is established. In the study small and medium-sized firms from a newly industrialized country (Korea) were considered, since such firms are as likely to seek cooperation for projects undertaken at home as to seek opportunities in foreign markets.

The study revealed that even though there is no significant impact of cultural distance on control preferences yet firms tend to feel more comfortable in their domestic environment and prefer to enter into business arrangements that give them more control. However, investment direction was also found to be playing an important role in the relationship between cultural distance and control preferences. Therefore, when the impact of cultural differences on the level of control sought over inward and outward investments was compared, the impact of cultural distance was greater in inward investment than in outward investment. So firms welcoming inward investment commit fewer resources because of their unfamiliarity with the partner firm's culture. As per the results firm age, firm size and number of competitors in the industry do not have a significant influence on the control preferences of the small firms. However, the number of chaebol firms in the industry i.e. group of large conglomerates was found to be significantly and negatively impacting the control preferences of the small sized firms. Further the advertising intensity typical of an industry showed a positive relation with the amount of control to be exercised. Firms that invest more in advertising might thus have more incentive to better use this capability in cooperative ventures by insisting on having more control. It was also found that firms that export more have less incentive to focus on cooperative ventures and so do not pursue high control.

The results provide support for the cultural familiarity theory, confirming the importance of culture in FDI decisions. The findings support the view that interacting with a partner is just one aspect of the interaction involved in undertaking an International Cooperative Venture (ICV). The findings also reaffirm the importance of examining the local partner's perspective in ICVs and that of examining a partner's strategic intentions prior to the bargaining game that determines the ICV's control structure. The research suggests that it is valuable to see that cultural distance asymmetry exists and that it makes a difference in firms' investment preferences (Shenkar et al, 2008).

Mehta et al (2006) empirically examine whether cultural differences affect trust, commitment, and cooperation in international marketing channel alliances between U.S. exporters and their foreign distribution partners. The study put forward that to work together successfully, the channel partners have to believe each other (trust), be willing to assist each other on a regular rather than on an ad hoc basis (commitment), and work together to achieve their goals (cooperate). Thus, the creation, nurturing, and sustaining of strategic alliances in international export channels must be based on substantial degrees of trust, commitment, and cooperation on the part of all channel members. To test the hypotheses, data were drawn from a sample of manufacturers of a variety of industrial products who depend on foreign distributors to market these products overseas.

The research explains the relationship between the degree of cultural difference and the levels of trust, commitment, and cooperation, exhibited by international strategic alliance partners in export channels. The study revealed a high level of consistency with which U.S. manufacturers assessed their international channel partners. Moreover, those international partners in export channels which were categorized by large cultural differences exhibited similar levels of trust, commitment, and cooperation with one another, while those that were categorized as culturally similar exhibited similar levels of commitment, cooperation, and trust. In addition, international alliances between culturally similar exporters and distributors exhibited greater trust, greater commitment, and greater cooperation than international alliances between culturally different exporters and distributors. Therefore, they conclude that when cultures are substantively different, trust, commitment, and cooperation among channel members are more difficult to attain. When cultural differences exist between exporters and their foreign channel partners, the alliance can be undermined if the cultural differences are significant enough to affect the communication process between the channel partners. Thus managers responsible for developing exports via foreign distributors need to pay close attention to the challenge of cultural differences in the channel (Mehta et al, 2006).

Johnson et al (2006) propose a definition of Cross-Cultural Competence (CC) as it applies to international business and develop a model for understanding how CC is nurtured in individuals. They view CC in terms of the ability of an individual to respond in different cultural contexts on the basis of the individual's knowledge, skills and attributes. The three dimensions of CC are identified as knowledge, skills, and personal attributes. The knowledge dimension of CC includes specific and general knowledge, knowledge about culture, knowledge of language, and knowledge about the rules of interaction. Skill is the 'expertness, or practiced facility in doing something'. It is the behavioral component of CC. The personal attributes dimension includes personality traits in addition to the internalized values, norms and beliefs of one's home culture. Personal attributes are treated as antecedents that can either help or hinder the development of CC. Two environmental factors namely institutional ethnocentrism and cultural distance were also identified whose presence can impede CC in the IB context.

The researchers predict that individuals who do not possess sufficient knowledge, skills and attributes will not be able to perform well on CC whereas the individuals who are high on these dimensions are likely to perform well. Further on integrating CC with cultural intelligence it is found that cultural intelligence plays an important role as a hidden construct in the development of CC. It is also found that cross cultural training programs give too much of importance to factual and conceptual knowledge rather than on developing the three CC dimensions. They acknowledge that cultural factors are only one among the many factors that can result into failures in international business. There are the external influences arising from political policies, legal practices, economic forces, and geographic influences as well as contextual influences that can hinder effective cross-cultural communication. Also problems may arise within the functional areas of companies operating abroad (Johnson et al, 2006).

Shenkar (2001) presents a critical review of the cultural distance construct, outlining its hidden assumptions and challenging its theoretical and methodological properties. Cultural Distance (CD) construct attempts to measure the extent of similarity and difference in different cultures. CD has been used widely to study foreign direct investment, headquarter-subsidiary relations, and expatriate selection and adjustment. There are three primary thrusts for the CD construct in the FDI literature namely foreign market investment location and the sequence of such investment by multinational enterprises (MNEs), to predict the choice of mode of entry into foreign markets and to account for the variable success, failure and performance of MNE affiliates in international markets for which inconsistent results have been obtained over the years which might be the result of the conceptual and/or methodological properties of the CD construct. The properties are hidden assumptions not supported by either logic or empirical evidence and are in the form of two groups, one originates from the conceptual properties of the construct, and the other from the methodological properties of the construct. Conceptual properties create illusions that are at the centre of the CD construct and weaken its validity within the context of FDI theories. Methodological properties present instrumentation and measurement biases that distort the accurate measurement of cultural differences.

The conceptual properties include the illusion of symmetry according to which distance is symmetric, illusion of stability that assumed CD to be constant at a single point o time, the illusion of linearity i.e. embedded in the distance metaphor is the assumption of linear impact on investment, entry mode and performance. The linearity assumption implies that higher the distance between cultures, the higher the likelihood that (a) investment will occur at a later stage in the investment sequence, (b) a less controlling entry mode will be chosen, and (c) the worse the performance of foreign affiliates will be. The illusion of causality implicitly assumes that CD has a causal effect on FDI pattern, sequence and performance and the illusion of discordance is the implicit assumption that differences in cultures produce lack of "fit" and hence an obstacle to transaction is questionable.

On the other hand methodological properties include assumption of corporate homogeneity which implies that the CD index used to measure the construct relies on national culture measures and implicitly assumes lack of corporate culture variance, the assumption of spatial homogeneity i.e. measuring distance from one national culture to another the CD index assumes uniformity within the national unit and the assumption of equivalence implies that it is subject to same criticism as Hofstede's cultural framework.

The author has developed an integrative framework for the treatment of CD construct. Unlike the existing literature that focuses on what makes the cultures different he also put emphasis on closing CD. A number of key mechanisms with the potential of closing cultural distance include globalization and convergence, geographical proximity, increased communication and interaction, acculturation, staffing, foreign experience, cultural attractiveness. He holds the view that the word distance in CD should be replaced by friction. Friction is implied to mean the scale and essence of the inter-face between interacting cultures, and the "drag" produced by that interface for the operation of those systems.

Based on the research the author recommends that measures of general cultural similarity which do not assume linearity, additivity and normal distribution should be used in conjunction with other measure. Further national level data should be supplemented by cognitive CD measures. Also closing distance mechanisms such as cultural attraction, acculturation, foreign experience and geographical distance which have already been found to correlate with CD or to mediate or moderate its impact on FDI should be controlled (Shenkar, 2001).

Welch et al (2001) attempt to unbundle the impact of language through an examination of the way in which language influences the pattern of foreign market expansion and an analysis of how a firm may try to cope with language diversity by adopting a common corporate language.

The study reveals that there is a strong inclination for companies to stay within the same language group in their initial international ventures as a way of minimizing the perceived demands and risks involved. The authors identified a range of possible language groups and related internationalization paths. There are a number of ways in which firms can seek to avoid or minimize the impact of language differences as they internationalize. Many firms have traditionally used trading companies to handle their international operations, thus effectively outsourcing the language issue. Firms have also used their obtained expertise in operating in English in a range of English-speaking countries, thereby reducing the language demands of continuing international expansion. However, firms from English-speaking countries face the threat that taking the English language path may create difficulties in understanding the extent of differences between countries that are hidden by a shared language.

The major challenges faced by the management of the firms that operate internationally in multiple language contexts are related to communication and information flow among their diverse operations, locations and languages. These challenges are faced both at the individual and the organizational level, affecting internal interaction among sections, departments and divisions and between headquarters and subsidiaries. One of the major findings was that language proficiency can give the individuals increased power beyond the formal position particularly at the subsidiary level. The research analyses ways in which firms attempt to cope with the various demands that arise on account of multiple languages. One of the ways of dealing with the various demands is to transfer staff between headquarters and subsidiaries. Some other ways could be the use of translators in case there is no common language in between the different subsidiaries or to adopt a company language that is usually English for internal communication, formal reporting and information flow. While information technology and communications have attempted to reduce the hindrances in international business it cannot do away with the need for a local language in business operations. Further the spread of English might contribute to the false perception that language is no more a cultural barrier.

The exploration of the issues posed by language differences has revealed how persistent they are for companies from the earliest stages of internationalization to more mature, large-scale operations. Some companies are able to avoid the need to cope with language differences for some time because they are able to operate in a widely used mother tongue, such as English. However, even in such cases, global expansion eventually exposes all companies to the demands of dealing with multiple language environments. The study reveals that common corporate language can create more problems than it solves. A common corporate language may merely push the burden of handling the language adjustment process further down the hierarchy at the subsidiary level. Even when there has been early adoption of a common corporate language, the demands of having to deal with multiple languages do not diminish over time because of moves into additional markets and often more linguistically distant domains (Welch et al, 2001).

Barkema &Vermeulen (1997) determine what differences in national culture are most troublesome for International Joint Ventures (IJVs). The study is built on Hofstede's five dimensions: power distance, uncertainty avoidance, individualism, masculinity and long term orientation. The authors tested the hypotheses on longitudinal data on 828 foreign entries (IJVs and international wholly owned subsidiaries (IWOS)) of twenty-five Dutch multinationals between 1966 and 1994.

The results show that cultural distance hurt IJV survival, if all five dimensions given by Hofstede are included in the cultural distance index. The results show that the incidence of IJVs increases with cultural distance. The findings imply that the chances of survival of IJVs decrease in uncertainty avoidance and long-term orientation rather than in the other three dimensions of cultural distance (individualism, power distance, masculinity). Differences in masculinity have a significant, negative impact on the survival of IJVs but the effect is smaller than the effects of uncertainty avoidance and long-term orientation. The authors find that differences in uncertainty avoidance and in long-term orientation, rather than differences along the other three dimensions, reduce a firm's inclination to establish IJVs in a foreign country. The effects of uncertainty avoidance and long-term orientation are negative and significant, which suggests that firms are reluctant to establish IJVs when differences in uncertainty avoidance and long-term orientation are large. In contrast, differences along the other three dimensions lead to a preference of IJV over IWOS. It is also found that the impact of cultural distance on IJV survival has not disappeared over time.

The results do not show a decrease in the effect of cultural distance over time. Therefore, differences in the cultural backgrounds of partners cause problems in IJVs. But some differences are more disruptive than others. Differences in uncertainty avoidance and long-term orientation in particular, cause problems. These differences have a negative impact on IJV survival and decrease the likelihood that firms enter a foreign country through an IJV rather than through an IWOS. These differences, which translate into differences in how IJV partners perceive and adapt to opportunities and threats in their environment are more difficult to resolve than differences along the other three dimensions. Perhaps cultural differences regarding power distance, individualism and masculinity are more easily resolved because they are mainly reflected in different attitudes towards the management of personnel for which explicit agreements can be entered into in between the partners (Barkema & Vermeulen, 1997).

Kogut & Singh (1988) studied the choice of entry mode by foreign firms in terms of country and industry patterns and analyzed statistically the factors that influence the choice between joint ventures, wholly owned Greenfield (start-up) investments, and acquisitions. The statistical investigation revealed the difference among the countries regarding their preference to enter by acquisition versus other modes. They used a multinomial logit model to test the hypotheses by analyzing data on 228 entries into the United States market by acquisition, wholly owned Greenfield, and joint venture. They explain the tendency of the managers of different countries to enter foreign markets using a particular mode of entry on the basis of the perception of the managers regarding the costs and uncertainty regarding alternative modes of entry into foreign markets.

If cultural factors influence differentially the perceived costs and uncertainty of the mode of entry, there should exist country patterns in the propensity of firms to engage in one type of entry mode as opposed to others. Due to the difficulty of integrating an already existing foreign management, cultural differences are likely to be especially important in the case of an acquisition. In contrast to the integration costs of an acquisition, a joint venture serves frequently the purpose of assigning management tasks to local partners who are better able to manage the local labor force and relationships with suppliers, buyers, and government. A wholly owned Greenfield investment avoids both the costs of integration and conflict over sharing proprietary assets by imposing the management style of the investing firm on the start-up while preserving full ownership. Thus they expect that the use of acquisitions by foreign firms entering the United States should be dissuaded, the more distant the culture of the country of origin.

They found that there is a clear difference in industry patterns among the mode of entry. At a higher level of aggregation, acquisitions tend to be relatively more common than other modes of entry in non manufacturing sectors of the economy. The effect of cultural distance is to increase the probability of choosing a joint venture over an acquisition. They found that greater the cultural distance between the country of the investing firm and the country of entry, the more likely a firm will choose a joint venture or wholly owned greenfield over an acquisition and the greater the culture of the investing firm is characterized by uncertainty avoidance regarding organizational practices, the more likely that firm will choose a joint venture or wholly owned greenfield over an acquisition.

The results showed that the larger the sizes of the American partner, the foreign firms are more likely to joint venture than acquire. However the effect of U.S Asset Size on choosing Greenfield indicates preference for acquisition over greenfield venture. The larger size of the foreign firm encourages Greenfield over acquisition. The results indicate that diversified firms tend to enter by joint venture or Greenfield. There is a preference for Greenfield investment over acquisition in the manufacturing sector. The most interesting of the industry-level variables is the positive effect of R&D on joint venture and Greenfield entry. Advertising is negatively related to joint ventures and Greenfield investments. The statistical estimations provide strong support that cultural distance and national attitudes towards uncertainty avoidance influence the choice of entry mode. The study suggests that when economic choice is compared across countries, cultural characteristics are likely to have thoughtful implications (Kogut & Singh, 1988).

CONCLUSION

The underlying study attempted to determine the impact of cultural differences on international business on the basis of review of literature. Based on the literature review cultural distance appeared to be mixed blessing for the international business. This is because while cultural distance creates a favorable environment for learning when integration capabilities are in place, it also has the potential to hinder the development of these capabilities. Cultural distance, therefore, has both cost and benefits in the context of international business. The study reveals that the performance of an international acquisition depends on the extent to which understandability, communication and key employee retention could be developed during the process of acquisition integration.

It was found that the advertising intensity in a particular industry has a positive relation with the amount of control to be exercised by the firm in the cooperative venture whereas the age and size of the firms do not hold an important place in determining the amount of control to be exercised by the firms. Moreover the study revealed that the firms that concentrate on exporting have less incentive to focus on cooperative ventures and so do not pursue high control.

Undoubtedly the cultural distance asymmetry exists and it is therefore an important factor in the determination of firm's investment preferences. The study revealed that the difference in the culture leads to difficulty in attaining trust, cooperation and commitment among the channel members. However, the study also revealed that failure of any international business is not solely on account of cultural asymmetry and many other factors combine together to result in an international business failure.

It was found that language influences the pattern of foreign market expansion of the business firms as companies tend to expand initially in the countries with the same language groups so as to minimize the risks involved in the expansion of the business. However over a period of time companies expand globally and try to deal with different language groups. Even though the development in information technology and communication has been able to remove a number of hindrances in international business but it has not been able to do away with the need to use the local language for almost all the local operations. Further adoption of a corporate language might create more problems for a business than it solves.

As far as the factors that influence the choice of the mode of entry in international business are concerned the study reveals that larger the cultural distance and uncertainty avoidance with regard to the organizational practices international business is likely to be carried in the form of International Joint Venture or wholly owned Greenfield rather than acquisition. Further the cultural distance also impacts the survival of the International Joint Venture. Also it has been found that International Joint Ventures are less likely to survive in uncertainty avoidance and long term orientation rather than in the other dimensions of cultural distance which are power distance, individualism and masculinity.

Over the period of time there is a realization that the term cultural friction should be used in place of the term cultural distance because globalization, technology, communication, staffing, foreign experience have the capability of minimizing the cultural distance.

SCOPE FOR FURTHER RESEARCH

Based on the current study a number of areas have been identified that can be explored in the future researches. The research can be carried out to explore the ways in which firms integrate their business when their cultures do not match. Research can also be undertaken to explore the factors that enable the acquirer firms to facilitate communication, understandability and key employee retention in the acquired firms.

Some studies only revolve around the firms of one country and their international business alliances. Researches can be carried out to test the results of such researches in the context of other countries.

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