Culture and capital flows—Exploring the spatial differentiation of China’s OFDI

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Abstract

Using a panel data of China’s OFDI over the period of 2003–2013, this study investigates how cultural distance and its dimensions explain China’s OFDI spatial differentiation. We find that cultural distance has a curvilinear (U-shaped) relationship with China’s OFDI. The growth rates of “liability of foreignness (LOF)” and “advantages of foreignness” (AOF) finally determine whether cultural distance cause conflicts or improve innovation. In addition, we find that how China’s OFDI activities are related to the difference of cultural distance hinges on the particular cultural dimension in question. The latter suggests that the relative weight of cultural dimensions should be considered in the calculation of cultural distance. Overall, this study makes important contributions to both theory and practice. Our findings offer important insights into OFDI activities and provide guidelines for managers about entry strategies.

1. Introduction

One characteristic of globalization is the expansion of investment flows (Yehoue, 2009). What determines the destination of outward foreign direct investment (OFDI) has long been an intriguing debate to academics and policy-makers (Du, Lu, & Tao, 2012). Most international business (IB) scholars argue the characteristics between countries, which includes a country’s geographic position, political regime, economic level and cultural setting, contribute to their attractiveness to foreign direct investment (Drogendijk & Martín Martín, 2015). While considerable attentions have been paid to the economic factors of the FDI recipient countries, the role culture play in related processes is relatively less addressed (Du et al., 2012). A different line of researches demonstrate that the greater the differences between countries, the more difficult it is to use strategies in the host market (Ambos & Håkanson, 2014; Brewer, 2007; Sousa & Bradley, 2006). Their perspectives need to be incorporated into the IB literature that dominate OFDI debate.

The two mainstream theories of location choice in foreign direct investment are the eclectic theory of international production (Dunning, 1977, 1981), and the internalization theory (Buckley & Casson, 1976). Both of them suggest that culture affects costs and revenue, and hence influence corporate investment area selection (Xu, 2014). Kogut and Singh (Kogut & Singh, 1988) were the first to convert Hofstede’s national culture dimensions (Hofstede, 1980) into one aggregate measure of cultural distance among countries to form the formative index, Kogut-Singh Index (KSI). Since then the measurement has been used extensively to explain the OFDI
locational decisions of multinational enterprises (MNEs).

By far, empirical results on the relationship between cultural distance and OFDI are mixed and inconsistent. Some scholars find that cultural distance may cause “liability of foreignness” (LOF) (Nachum, 2003; Zaheer, 1995). The difference in culture positively increases the uncertainty and costs of OFDI, and creates ambiguities in relationship, which could threaten the survival and performance of international joint ventures (Davidson, 1980; Dunning, 1981; Loree & Guisinger, 1995; Tang, 2012; Zaheer, 1995). Others find that cultural distance may cause “advantages of foreignness” (AOF) (Morosini, Shane, & Singh, 1998; Un, 2011). The existence of cultural distance provides the basis for powerful MNEs to carry out different strategies and to set up their own brands in host countries (Bhaumik & Co, 2011; Evans & Mavondo, 2002). These mixed results make the impact of cultural distance on OFDI an interesting question for empirical study. Additionally, while recognition of dynamism in cultural distance and the role of contextual factors has received some attention (Leung, Bhagat, Buchan, Erez, & Gibson, 2005; Shenkar, 2001, 2012), attempts to incorporate such dynamic aspects in empirical studies are in a preliminary stage (Hutzschenreuter & Voll, 2008; Hutzschenreuter, Voll, & Verbeke, 2011; Popli, Akbar, Kumar, & Gaur, 2016).

As a transition economy, the pattern of China's OFDI deviates from that of advanced economy and other emerging economy. Traditionally, government promotion and the dominance of state-owned enterprises (SOEs) were key features of China's OFDI (Buckley, Cross, Tan, Xin, & Voss, 2008; Luo, Xue, & Han, 2010; Wang, Hong, Kafouros, & Boateng, 2012). Yet more recently, China's OFDI has appeared to be less influenced by the state, as more private firms have been involved in foreign investments (Ramasamy, Yeung, & Laforet, 2012). The combination of SOEs and private firms contributes to the importance and uniqueness of China's OFDI.

Guided by the aforementioned literature, we use Panel Corrected Standard Errors (PCSE) to investigate the impacts of cultural distance and its dimensions on China's OFDI using a panel data set from 2003 to 2013. The results suggest that: (1) there is a u-shaped relationship between cultural distance and China's OFDI; (2) each dimension of cultural distance has a different impact, more specifically, only Individualism Index (IDV), Uncertainty Avoidance Index (UAI), Long-Term Orientation (LTO) and Indulgence Versus Restraint (IVR) matter for China's OFDI.

The innovation of this paper can be summarized into three aspects. First, as Chapman et al. argue, the simple and static measures of cultural distance, which have been predominant in the international business literature, are not sufficient to understand this complex concept (Chapman, Gajewska-De Mattos, Clegg, & Buckley, 2008). We therefore take the length of diplomatic relations into account to improve KSI, and turn cultural distance into a dynamic variable. Second, in the broad contours of cultural differences perspective, rather than the difference between host and home country cultural scores, what matters is the actual positions of the two countries on cultural dimensions (Popli et al., 2016). Therefore, we consider the net value in each dimension rather than an absolute distance score between two countries when we study the impacts of different dimensions. Third, we add the fifth and the sixth dimension of Hofstede's national cultural distance, LTO and IVR, and use the updated scores in 2010 to measure cultural distance more comprehensively.

We contribute to current literature by suggesting the formula of KSI should be improved to consider the weights of different dimensions according to their contribution to cultural distance. Additionally, in practice, we appeal to bring different strategies into effect based on the cultural distance between China and host economy to help multinational enterprises achieve their goals successfully.

The rest of the paper is structured into four sections. First, we discuss development and spatial distribution of China's OFDI. This is followed by our literature review and the hypotheses regarding the impacts of both cultural distance and its dimensions. Next, we describe the methodology, report the empirical results as well as sensitivity checks and discuss the implications of our findings. In the end, we conclude our study and propose avenues for future research.

2. Evolution and spatial distribution of China's OFDI

Having broadly reshaped the global economic geography (Dunning, 1998), China's OFDI has become a debated topic in the academic literature because of its rapid increase and unconventional patterns (Cozza, Rabellotti, & Sanfilippo, 2015).

2.1. Evolution of China's OFDI

China's OFDI formally started in 1979 and developed rapidly, with China entering the WTO in the 21st century. As shown in Fig. 1, from 2003 to 2013, although China's OFDI increased in a wave, its net flow reached $107.84 billion in 2013, increased by 22.8% compared to the previous year, which was about 40 times the net flow in 2002. Despite of its high growth, China's OFDI stock is far less than that of developed countries. By the end of 2013, China's OFDI stock had reached $660.48 billion. This was only equivalent to 10.4%, 35%, 38.6%, 40.3% and 66.5% respectively of the stock of the United States, the United Kingdom, Germany, France and Japan during the same period. The global proportion of China's OFDI rose from 0.44% in 2002 to 2.5%, ranking NO.11 in the world.¹

2.2. Spatial distribution of China's OFDI

Fig. 2 shows the regional distribution of China's OFDI flows in 2013. It is evident that China's OFDI is spatially concentrated.

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