



## **National Cultural Differences and Multinational Business**

The eminent Dutch psychologist, management researcher, and culture expert Geert Hofstede, early in his career, interviewed unsuccessfully for an engineering job with an American company. Later, he wrote of typical cross-cultural misunderstandings that crop up when American managers interview Dutch recruits and vice versa:

“American applicants, to Dutch eyes, oversell themselves. Their CVs are worded in superlatives...during the interview they try to behave assertively, promising things they are very unlikely to realize...Dutch applicants in American eyes undersell themselves. They write modest and usually short CVs, counting on the interviewer to find out by asking how good they really are...they are very careful not to be seen as braggarts and not to make promises they are not absolutely sure they can fulfill. American interviewers know how to interpret American CVs and interviews and they tend to discount the information provided. Dutch interviewers, accustomed to Dutch applicants, tend to upgrade the information. To an uninitiated American interviewer an uninitiated Dutch applicant comes across as a sucker. To an uninitiated Dutch interviewer an uninitiated American applicant comes across as a braggart.”<sup>1</sup>

Cultural differences, while difficult to observe and measure, are obviously very important. Failure to appreciate and account for them can lead to embarrassing blunders, strain relationships, and drag down business performance. And the effects of culture persist even in life-and-death situations. Consider the example of Korean Air's high incidence of plane crashes between 1970 and 2000. As an analysis of conversations recorded in the black boxes of the crashed planes revealed, the co-pilots and flight engineers in all-Korean cockpits were too deferential to their captains. Even in the advent of a possible crash, Korean Air co-pilots and flight engineers rarely suggested actions that would contradict the judgments of their captains. Challenging one's superior in Korea was considered culturally inadequate behavior.<sup>2</sup>

The Korean Air example is particularly noteworthy for two reasons. First, if national culture can have significant – not to say existential – consequences among people of the same cultural origin, we need to be very cautious in how we deal with national cultural *differences* in cross-border interactions. Second, it is interesting to note that the attitudes and behaviors revealed by Korean Air co-pilots and flight engineers persisted in such a highly regulated environment like commercial aviation. National culture shapes behavior and this influence reaches beyond administrative attributes such as governmental policies, laws and public institutions. Therefore, this note focuses on how the influence of culture materializes and how cultural differences affect the operation of firms around the globe.

For the purpose of this note, *culture shall be defined as a set of shared values, assumptions and beliefs that are learnt through membership in a group, and that influence the attitudes and behaviors of group members*. This definition includes three key characteristics: First, culture can be understood as a group phenomenon that distinguishes people of one group from another. From this perspective, cultures exist at many different levels, including organizational functions or business units, occupational groups, organizations, industries, geographical regions, and nations.<sup>3</sup> This note focuses in particular on national culture and the role of cultural differences across countries rather than other cultural groups because this level of culture is particularly relevant for multinational business.

Second, the above definition implies that culture is not obtained by birth but rather acquired through a process of socialization. The learning of shared values, assumptions and beliefs occurs through interactions

with family, teachers, officials, experiences, and society-at-large. In this respect, Geert Hofstede speaks of culture as a process of “collective programming of the mind”<sup>4</sup>. Third, it is this collective programming that determines what is considered acceptable or attractive behavior. In other words, cultural values provide preferences or priorities for one behavior over another.

It is important to note that national cultural differences have remained fairly stable over time. While at the surface level there may be some convergence in cultural habits, artifacts and symbols, for example as witnessed by the spread of American consumer culture across the globe, at a deeper level cultural differences persist. For example, data from the World Value Survey, a study of 65 countries reflecting 75% of the world’s population, showed a remarkable resilience of distinctive cultural values even after taking into account the far-reaching cultural changes caused by modernization and economic development.<sup>5</sup> Consider the following high-stakes example. You are riding in a car with a close friend, who hits a pedestrian. “You know that he was going at least 35 miles per hour in an area of the city where the maximum allowed speed is 20 miles per hour. There are no witnesses. His lawyer says that if you testify under oath that he was only driving 20 miles per hour it may save him from serious consequences.” More than 90% of managers in Canada, the United States, Switzerland, Australia, Sweden, Norway, and Western Germany reported that they would *not* testify falsely under oath to help their close friend, while fewer than half of managers in South Korea (26%), Venezuela (34%), Russia (42%), Indonesia (47%), and China (48%) said they would refuse to testify falsely in this hypothetical situation.<sup>6</sup> Some cultures put more emphasis on *universal* commitments (like honesty) while others put more weight on loyalty to *particular* people and relationships. Thus, the potential for misunderstanding is large, even between wealthy and deeply inter-connected countries like the United States and South Korea.

The persistence of cultural value differences is particularly relevant for large multinational companies that are exposed to *multiple* national cultures in their daily operations. This suggests that managing across borders introduces substantial complexity because it forces multinationals to tailor their practices and approaches to each and every cultural context they operate in. Therefore, while the concepts discussed in this note will apply to different aspects of cross-border activities, the primary focus is on multinational business firms.

Section 1 of this note discusses cultural frameworks and value dimensions that have been used to study national cultural differences. These frameworks are subjective in the sense that they are based on data that were self-reported by individual members of cultural groups. Section 2 introduces a range of objective indicators of cultural differences. Section 3 examines how culture shapes various aspects of multinational business. Section 4 discusses business implications and how multinational companies can manage adaptation to cultural differences.

## I. Cultural Frameworks

The analogy of an iceberg is useful to conceptualize culture as consisting of different layers.<sup>7</sup> Certain aspects of a culture are more visible, just like the tip of an iceberg. This manifest culture includes observed elements such as behaviors, language, music and food. A deeper understanding of a culture only develops by looking at the submerged tip of the iceberg. This deeper layer consists of expressed values that reflect how cultural members explain the manifest culture. Finally, the very bottom of the iceberg consists of basic and taken-for-granted assumptions which form the foundations of each culture. It is these basic assumptions that provide the ultimate meaning to the expressed values and behaviors. For example, in many Asian cultures it is considered rude not to carefully study a business card that is presented to you because business cards reflect a person’s professional identity, title and social status. Failing to study the business card is therefore a sign of disrespect towards that person. In other words, the ritual of exchanging business cards (a behavior) can be explained by the deeper-seated meaning that is associated with business cards in this particular context (expressed values). The expressed values, in turn, can only be fully understood by taking into account the underlying importance of respect towards seniority and status in that culture (basic assumptions).

Dealing with national cultural differences therefore requires not only knowledge about adequate behaviors but, more importantly, an understanding of deeper-level assumptions and values that explain why certain behaviors are more appropriate than others. A number of cultural frameworks exist that characterize and describe cultures along different value dimensions.

### Hofstede's Cultural Dimensions

The most widely used framework for categorizing national cultures is the one developed by Geert Hofstede, a Dutch social psychologist and management scholar.<sup>8</sup> The data used to derive relevant cultural value dimensions came from IBM employee surveys conducted between 1967 and 1973 in more than 50 cultures. Analysis of responses from over 116,000 IBM employees to questions about their job and work settings revealed systematic cultural differences across four dimensions: *power distance*, *individualism/collectivism*, *uncertainty avoidance*, and *masculinity/femininity*.

Probably the most important cultural dimension identified in Hofstede's research is *power distance*, which concerns the degree to which a culture accepts and reinforces the fact that power is distributed unevenly in society. Members of high *power distance* cultures such as Malaysia accept status differences and are expected to show proper respect to their superiors. Status differences exist within the organizational hierarchy but they may also be based on age, social class, or family role. It is important to note that although these differences in rank will always be evident, a superior in a high *power distance* culture will treat those at lower levels with dignity. Low *power distance* cultures such as Denmark are less comfortable with differences in organizational rank or social class and are characterized by more participation in decision-making and a frequent disregard of hierarchical level. The concept of *power distance* helps to explain the importance of deference Korean Air's co-pilots showed towards their captains. It is important to note, however, that a culture's position along a certain cultural dimension (e.g., the higher level of power distance in Korea) is not an evaluation of whether members of that culture approach situations better or worse than in other cultures. Instead, the cultural dimensions simply demonstrate different preferences or priorities for how issues should be approached.

A second dimension Hofstede identified is *individualism/collectivism*. Individualist cultures show a relative preference for the individual in contrast to the group. Members of *individualist* cultures such as the UK maintain loose social structures that are characterized by independence, the importance of individuals' rights and the recognition of personal initiative and achievement. In contrast, *collectivist* cultures such as Venezuela value the overall good of and loyalty to the group. Members of *collectivist* societies clearly distinguish between in-groups and out-groups and are expected to subordinate their individual interests for the benefit of their in-groups (e.g., family, organization). In Hofstede's research, this cultural dimension was shown to strongly correlate with *power distance*, which means that *individualist* cultures tend to have a preference for lower *power distance*. A notable exception is France where a preference for status differences (relatively high power distance) goes hand-in-hand with a focus on individual rights and personal achievement.

*Uncertainty avoidance* concerns the degree to which cultural members are willing to accept and deal with ambiguous or risky situations. Cultures with high levels of *uncertainty avoidance* such as Greece prefer structure and predictability, which results in explicit rules of behavior and strict laws. Members of these cultures tend to be risk averse towards changing employers, embracing new approaches, or engaging in entrepreneurial activities. In societies with low *uncertainty avoidance* such as Singapore there is a preference for unstructured situations and ambiguity, which favors risk taking (i.e., starting a new business), innovation and the acceptance of different views.

The fourth dimension Hofstede identified is *Masculinity/Femininity*. *Masculine* cultures such as Japan are thought to reflect a dominance of tough values such as achievement, assertiveness, competition and material success, which are almost universally associated with male roles. In contrast, *feminine* cultures focus on tender values such as personal relationships, care for others, and quality of life. In addition, *feminine* cultures such as Sweden are also characterized by less distinct gender roles. Compared to *masculine* cultures,

firms in feminine cultures place a relatively stronger emphasis on overall employee well-being rather than bottom-line performance.

Based on the responses to the IBM employee surveys, Hofstede was able to compute average scores for each national culture involved in the study along these four dimensions. Over the years, Hofstede's study has been replicated by other scholars and extended to over 80 cultures for which data on the four dimensions are available. **Exhibit 1** lists the cultural scores for each dimension across 30 selected cultures. Using these scores, Hofstede developed national cultural profiles to compare cultures and highlight cultural differences (see **Exhibit 2**). This provides a useful tool to analyze what to expect when entering into a new culture and which value differences will be relatively more pronounced.

### Limitations of Hofstede's Cultural Framework

Although Hofstede's framework remains the most widely used approach to classify and compare national cultures, it is not without limitations. An obvious weakness is that the data are relatively old and, despite the study's replications, may not fully capture recent changes in the political environment (e.g., the end of the Cold War and the decline of communism) or the work place (stronger focus on cooperation, knowledge-sharing and empowerment). Furthermore, Hofstede's study was restricted to data from a single organization. Generalizing about national cultural characteristics based on the analysis of a small subset of cultural members relies on the untenable assumption that each nation consists of a uniform national culture and that data from a section of IBM employees would be representative of that supposed national uniformity.<sup>9</sup>

It is also worth noting that the dimension of *uncertainty avoidance* did not emerge as a distinct cultural dimension in a later study that Hofstede conducted using a Chinese equivalent of his original survey developed by Chinese social scientists.<sup>10</sup> Based on data from 23 countries, including 20 from Hofstede's original study, the scholars identified a different fourth dimension representing Chinese values related to Confucianism. Originally termed Confucian Work Dynamism, this dimension was later re-labeled *long-term/short-term orientation* and added as a fifth dimension rather than replacing *uncertainty avoidance*. Therefore, while the dimension of *uncertainty avoidance* is conceptually relevant, its applicability is necessarily limited. Further, beyond the mere confusion associated with the labels of *masculinity* and *femininity*, it is also less clear what exactly this dimension involves. For example, the finding that Japan scored as the most *masculine* culture appears to contradict the high levels of concern and care that Japanese organizations usually show towards their employees and that would be more indicative of a *feminine* culture as defined by Hofstede. It is possible that four cultural dimensions are simply insufficient to capture the complexity of national culture.

Hofstede's cultural value scores have also been used to compute aggregate cultural distances between countries along these four dimensions in order to quantify cultural differences between countries.<sup>11</sup> Although these cultural distance scores have been widely used to explain different phenomena in international business such as entry mode choice, international diversification, and performance of multinational companies<sup>12</sup>, this approach has also been heavily criticized.<sup>13</sup> First, the calculation of distances based on Hofstede's scores suggests that the distances are symmetric. In other words, a Swedish firm investing in China is thought to face exactly the same cultural distance as a Chinese firm investing in Sweden, an assumption that has however received little support.

Second, the concept of cultural distance assumes homogeneity within each nation, a criticism already voiced against Hofstede's data collection per se. It becomes even more serious when the data are then used to compute distance scores between countries, taking into account neither different intra-cultural variations nor the actual physical distance between both locations. For example, we would expect significant differences for a Spanish firm investing in France depending on whether the home and host units are located in Barcelona and Perpignan, respectively, or in Seville and Le Havre, respectively. This is particularly relevant for large and diverse countries like the BRICs (Brazil, Russia, India, and China) but it also applies to smaller countries: The computed cultural distance between the Czech Republic and Slovakia, two states that shared the same national flag for a long time, is higher than for most other cultural pairs! This not only highlights the role of

intra-cultural variation but it also raises doubts over whether the country is necessarily a suitable proxy for defining cultural regions.

### Other Cultural Frameworks

In addition to Hofstede's work, a number of other frameworks exist that categorize national cultures along different dimensions. While some dimensions conceptually match the ones identified by Hofstede's a few others are worth mentioning. Fons Trompenaars, another Dutch researcher, collected more recent data in over 40 countries. Out of the seven dimensions identified in his study, five focus on relationships between people (for example the relative importance of applying universal and standardized rules across cultural members, or the extent to which people are free to express their emotions in public) whereas the remaining two dimensions concern time management and a culture's relationship with nature.<sup>14</sup> Shalom Schwartz, an Israeli psychologist, provides yet another approach to describe and classify national cultures. Schwartz argues that cultural values reflect three basic issues societies are confronted with: the nature of the relation between the individual and the group, how to guarantee responsible behavior, and how to regulate the relation of people to the natural and social world. Using data from schoolteachers and university students in over 60 countries, Schwartz derived three dimensions that represent solutions to the above issues.<sup>15</sup> In one of the most ambitious efforts to characterize cultures, an international team of researchers around Robert House mainly focused on cultural differences in leadership. Termed the GLOBE study (Global Leadership and Organizational Behavior Effectiveness), the research derived nine cultural dimensions that addressed both previously identified (e.g., power distance and individualism/collectivism) and new (e.g., gender egalitarianism and performance orientation) value categories.

It is important to note that the application of any of the cultural value dimensions described above comes with an important caveat. While the cultural frameworks are certainly useful in comparing one culture with another, they only represent central tendencies at the level of the nation rather than a description of specific individuals within that nation. Information about the actual values and behaviors of a particular individual should therefore always supersede the group tendency.

## 2. Objective Indicators of Cultural Differences

Objective indicators of cultural differences abound at the behavioral level and become progressively more elusive as one moves through the levels of expressed values toward basic assumptions. As we get farther away from those aspects of difference that are directly observable, the comparisons themselves become subject to greater degrees of uncertainty as they inevitably rely on theoretical positions linking observable behaviors to thought processes that are not directly observable.

Cultural differences at the level of behavior form the basis for much of the casual comparison that takes place in diverse settings like business schools, for both serious and humorous purposes. Citizens in the United States maintain a culture around owning guns that most Europeans can't fathom. The Czechs drink far more beer than people in Saudi Arabia, and even more than the Irish, who come in second.<sup>16</sup> India and China are so close geographically that they still haven't resolved their territorial disputes, but couldn't display more distinct food cultures, particularly around which animals and parts of animals should or shouldn't be eaten. Argentines see psychotherapists more often than other nationalities. Brazilians spend a higher proportion of their income on beauty products than the citizens of any other major economy.<sup>17</sup> And so on.

Focusing on the submerged tip of the iceberg that reflects the level of expressed values, one objective indicator of differences is the diversity of religious beliefs around the world. According to the World Christian Encyclopedia, "there are 19 major world religions, which are subdivided into 270 large religious groups, and many smaller ones." The largest high-level groupings are Christianity (33% of the world population in 2000), Islam (21%), non-religious (16%), and Hindu (14%). And the diversity within these, as well as smaller religious groupings, is tremendous. The world's 2.1 billion Christians subdivide into some 34,000 separate groupings!<sup>18</sup> The fact that the largest religion in the Czech Republic is Christianity (in which wine is consumed as part of ritual practice) and an even larger number of Czechs are not religious, while the

official religion of Saudi Arabia is Islam (which prohibits alcohol consumption), is probably the best explanation for those countries' widely divergent alcoholic beverage sales. Similarly, we can understand dietary differences between Indians and Chinese in large part based on religious distinctions.

Most research using religion as a marker of cultural differences has focused only on the binary condition of whether or not national communities share a common religion. Based on a sample of 163 countries, 51% of country pairs have at least thirty percent or more of both populations practicing the same religion. But that analysis does not account for differences between denominations within religions. Metrics that do exist of religious distance treat commonalities at the level of denomination or sect as closest (e.g. Methodist), then consider matches at broader levels of aggregation within a single religion (e.g. Protestant), then at the level of a religion (e.g. Christianity), and then most broadly combine groups of religions with a similar origin and some common beliefs (e.g. "monotheistic religions of a common Middle-Eastern origin," the category that encompasses Judaism, Christianity, and Islam).<sup>19</sup> Note also that religions differ in their level of internal diversity.<sup>20</sup>

Language is another observable aspect of culture, which according to some researchers offers a window into deeper beliefs and thought processes.<sup>21</sup> Writing on potential implications of linguistic differences on thought patterns across cultures dates back at least to early work by Edward Sapir (1921)<sup>22</sup> and Benjamin Whorf (1940).<sup>23</sup> Michael Agar provided the following description of the language's deeper impact, "Language carries with it patterns of seeing, knowing, talking, and acting...patterns that mark the easier trails for thought and perception and action."<sup>24</sup> Later scholars, particularly in the 1960s, moved decisively away from this view as they focused on universal patterns across languages, but more recently research in linguistics has again shown a "growing appreciation of how interpretive differences can be rooted as much in systematic uses of language as in its structure."<sup>25</sup>

One simple way to summarize the persistence of linguistic differences is to note that among the same sample of 163 countries referenced above, in only ten percent of the country pairs do twenty percent or more of the populations of both countries speak a common language.<sup>26</sup> Furthermore, the concept of linguistic distance allows us to measure cultural distance based on the genealogical classification of languages, i.e. the presence of common linguistic ancestors. **Exhibit 3** presents such a linguistic distance table calculated versus English as the focal language.

What is particularly interesting about the use of linguistic distance as an objective indicator of cultural differences is that it has been shown to correlate with cultural distinctions such as those described in the previous section. Two examples will be presented here, based on distinctions between English and Spanish that will be familiar to many readers. First, consider Hofstede's dimension of *individualism/collectivism*. English speaking cultures are considered more *individualistic* (they score 84 on this dimension) whereas Spanish speaking cultures are deemed more *collectivistic* (22). Linguistically, the requirement in Spanish, but not English, to specify a person's gender when describing his or her occupation is seen as reflecting the collectivist pattern of rooting description in social context. English, by casting aside the requirement to communicate such contextual information, "tends to elevate individuals vis-à-vis their groups."<sup>27</sup> Hofstede's dimension of *power distance* is also related to linguistic differences between Spanish and English. Spanish speaking countries score much higher on this dimension (69) versus English speaking countries (32). And in Spanish, we note the distinct formal (usted) and informal (tu) forms of the English "you." This hierarchical emphasis is also seen in speech patterns such as the tendency in Mexico to introduce an engineer as "ingeniero" or a lawyer as "licenciado" whereas both would just be called "mister" in English.<sup>28</sup> More sophisticated statistical tests have also validated linguistic distance as a marker of cultural distance.

In addition to serving as observable markers of cultural differences at deeper levels than behavior, religion and language categories are also useful for grouping countries. It quickly gets overwhelming to try to look at the world in terms of countries where business cards are received in particular ways or in terms of the presence or absence of particular ingredients in local cuisine. Thinking in terms of countries where English is the main language or where most of the population are Catholic can be useful, though again one has to be careful of oversimplification. More sophisticated efforts at classifying countries into cultural clusters have often relied on geography, language, and religion as primary factors, while others have also

used cultural frameworks such as Hofstede's as well as levels of economic development.<sup>29</sup> The clusters resulting from a synthesis across eight such studies are shown in **Exhibit 4**.

### 3. Effects of National Cultural Differences

One broad indicator of the effects of cultural differences is provided by patterns of trust within versus between countries. The best data available come from Eurobarometer surveys that measure trust among citizens of different countries, mainly within Europe.<sup>30</sup> Surveys in 16 West European countries asked people whether they trusted their countrymen, the citizens of the other 15 countries, and people from some East European countries, Japan, the United States, and China "a lot."<sup>31</sup> The results are summarized in **Exhibit 5**. In Sweden, for example, the data indicate differences between trust in fellow citizens (64%), in other Nordic countries (63%), in the remaining European countries in the sample (40%), and trust in all other countries (29%). Scholars looking to explain patterns of international trust have concluded that trust falls as the populations of any two countries grow more different in terms of their languages, religions, genes, body types, geographic distance, and incomes, and if they have a more extensive history of wars.<sup>32</sup>

To provide a more systematic review of the effects of cultural differences, this section will review impacts on four types of international flows: information, people, products, and capital. We begin with information flows because economists often consider information costs (an aspect of transaction cost) as a factor that reduces the other types of flows. People flows are treated next because of the importance of relationships in facilitating product and capital flows, which are covered third and fourth, respectively.

As we have seen, linguistic differences are a useful proxy for cultural differences. One way of quantifying the impact of language barriers on information flows is to look at the intensity of international telephone calls on a population-weighted basis. The intensity of minutes of phone calls between countries where at least twenty percent of the populations share a common language is ten times greater than between other countries.<sup>33</sup> The impact of language barriers on information flows is also seen in the analysis of patent citations. According to one study conducted in Europe, "having the same language increases the amount of knowledge flows between two regions by up to 28 percent."<sup>34</sup> And while language barriers are more amenable to quantification, one can easily think of other more subtle ways in which cultural differences impede information flows, ranging from misinterpretation to unwillingness to share information across cultural boundaries (note the information already presented on the geography of trust).

The impact of cultural differences on people flows are evidenced by migration patterns. 60 percent of migrants move to a country with the same major religion, and 40 percent go to a country with the same major language.<sup>35</sup> And research on diasporas and international business networks has shown migration to have an important effect on information flows as well as patterns of trade and investment. As one study noted, "in addition to being used to transmit information about past opportunistic business conduct, [diaspora] networks can be used to transmit information about current opportunities for profitable international trade (or investment)."<sup>36</sup>

Shifting to evidence directly linking cultural factors to product flows (trade), language is the factor that has been studied most widely. A common language has been shown to increase the bilateral merchandise trade between a pair of countries by 42 percent.<sup>37</sup> While there is less research on services trade, one study indicates that a common language increases services trade by 50 percent.<sup>38</sup> It seems reasonable that language barriers would be even more formidable when trading services rather than products. And it's useful to dig deeper into the impacts of linguistic differences on trade. While communication via a translator can indeed facilitate trade, one analysis indicates that "direct communication appears about three times more effective than indirect communication in promoting trade." And the same study also indicates that linguistic diversity within a country as well as higher levels of literacy promote foreign over domestic trade.<sup>39</sup> Language barriers have also been shown to pose more of a problem for those receiving information than those providing it, as evidenced by the finding that people tend to tune out on accents they have trouble understanding.

Countries that share a common religion have also been shown to trade more than countries that don't, with one study showing that a common religion increases trade by 22 percent.<sup>40</sup> Some religious

communities have also been shown to be more conducive to the development of international trade networks than others.<sup>41</sup> Hofstede's cultural framework has also been linked to trade flows. One of the more intuitive findings from such research is that "countries high in uncertainty-aversion export disproportionately less to distant countries (with which they are presumably less familiar)."<sup>42</sup> Other research looking at Hofstede's original four dimensions (and their aggregation into a single measure of cultural distance) has produced results that don't fit as well with theory and intuition. One study indicates that cultural distance actually increases bilateral trade, which its authors surmise may result from companies preferring to export to culturally different markets rather than invest to serve them via local production.<sup>43</sup> This, however, contrasts with the general view that cultural differences are an impediment to trade.

Much research has also been done linking Hofstede's cultural framework to foreign investment flows, and in particular to patterns of foreign market entry. A summary article reports that, "Firms from countries with large *power distance* prefer subsidiary and equity JV entry modes whereas firms from countries high in *uncertainty avoidance* prefer contract agreements and export entry modes."<sup>44</sup> The same summary article also cited various studies analyzing the effects of cultural distance on entry modes, though we have already noted methodological concerns about such studies: "Findings demonstrated that as the cultural distance between countries increased, the tendency to choose a joint venture (JV) over an acquisition increased. Also, as cultural distance increased, Japanese firms were more likely to choose green-fields or wholly owned subsidiaries over shared ownership; the tendency to choose licensing over JVs or wholly owned subsidiaries increased; the tendency to choose a greenfield over an acquisition increased; wholly owned subsidiaries were less preferred than either shared-equity ventures or technology licensing; the tendency to choose management-service contracts over franchising increased..."<sup>45</sup>

Moving beyond entry modes specifically, it has also been shown that "cultural distance is a significant deterrent to Foreign Portfolio Investment (FPI), with a coefficient one third the size of geographic distance...[and] Hofstede's *power distance* in the originating country is negatively related to cross-border debt and equity holdings...*uncertainty avoidance* is positively related to cross-border debt holdings...[and] both *masculinity* and *individuality* are positively related to cross-border debt and equity FPI."<sup>46</sup> Language differences have also been shown to have a significant and negative impact on Foreign Direct Investment (FDI).<sup>47</sup> Similar findings have also been found for M&A flows, however, one comparative study found that "while geographic, linguistic, and colonial variables explain 39% of variations in telephone traffic and trade, they explain only 24% of the variations in M&A flows."<sup>48</sup>

#### 4. Business Implications of National Cultural Differences

As we have seen, differences in national culture are reflected in business decisions, such as choices about foreign entry modes. But how can we use our understanding of national culture to make better decisions? The basic answer is that improving the alignment or congruence between management practices and cultural contexts yields tangible business benefits:<sup>49</sup>

- Participative management can improve profitability in low *power distance* cultures but worsen it in high *power distance* cultures
- Quick fixes can improve profitability in more *short-term oriented* cultures but worsen it in more *long-term oriented* cultures
- Merit-based pay and promotion policies can improve profitability in more *masculine* cultures and reduce it in more *feminine* cultures
- Emphasizing individual contributions can improve profitability in more *individualistic* cultures and worsen it in more *collectivistic* cultures

Based on such findings, this section proceeds to highlight key points that can help align business practices to national culture. It often makes sense to structure such analyses around the intersection of specific dimensions of cultural distance and business functions or activities in order to arrive at a meaningful level of specificity. Thus, we begin with a look at the implications of Hofstede's dimensions across functions,

focusing specifically on *power distance*. The section concludes with material on managing adaptation to cultural differences.

### Power Distance across Functions and Activities

This review of the implications of Hofstede's *power distance* begins at the company's external boundary (marketing) and progressively moves to more internally oriented functions (organization and human resources). The endpoints of this review, marketing and organization, are areas where human culture is of particular importance in the sense that marketing requires a deep understanding of customers and organization requires a deep understanding of employees; hence more extended treatments are provided in these areas.

Begin with humor as an introduction to the impact of national culture and *power distance* in marketing. Humor is widely employed in marketing communications and particularly apt to fall flat if not well tailored to national culture. According to one study, 63% of humorous television advertisements in Thailand and Korea (countries with high *power distance*) contain characters of unequal status, versus only 29% in the U.S. and Germany (countries with low *power distance*).<sup>50</sup> In fact the use of humor itself in advertising is more prevalent in countries with lower *power distance* as well as low *uncertainty avoidance*.<sup>51</sup> Indeed, cultural differences are one of the main impediments to globally standardized advertising campaigns.

High *power distance* also correlates with consumers making purchase decisions based on emotion rather than information, which has clear implications for advertising as well as other aspects of marketing communications. Shifting to public relations, research indicates that in countries with high *power distance* and *collectivism*, public relations focuses more on building and maintaining relationships whereas in low *power distance* and *individualistic* cultures, it entails more explicit dissemination of information. And looking at online marketing, "high *power distance* explains less consumer-marketer interactivity because of a larger gap between marketers and consumers." There also tend to be higher service expectations in high *power distance* cultures, and even the organization of products in retail stores has been shown to vary based on this dimension of culture.<sup>52</sup> *Power distance* may also impact adoption patterns of some products, as in the case of a negative impact found in the adoption of Enterprise Resource Planning (ERP) software.<sup>53</sup>

The link between marketing and innovation/new product development seems to work better when managed in a centralized way in cultures with high *power distance*.<sup>54</sup> And looking at innovation more broadly, there are studies indicating that countries with low *power distance* tend to have stronger innovation capabilities, which might impact a company's thinking about alternative locations for work requiring high levels of innovation. Low *uncertainty avoidance* and high *individualism* also correlate with innovation capability.<sup>55</sup> Marketing and product development both need to account for the impact of national culture on consumers' product preferences. In cultures with high *power distance*, consumers are more likely to want products that help them demonstrate their status, but there are also less obvious correlates. Consumption of mineral water and newspapers both correlate with *power distance*, along with more obvious dimensions (such as mineral water consumption fitting with higher levels of *uncertainty avoidance*).<sup>56</sup>

Entire books have been written on cross-cultural negotiations. A typical prescription is that in higher *power distance* cultures, the seniority of the negotiator (and size of the negotiating team) send important signals. Companies from low *power distance* cultures can run into trouble by sending a junior negotiator (who might be better versed in the content) or by trying to save money by limiting the size of the negotiating team. There are also indications that negotiators from high *power distance* cultures may be less attuned to synergistic negotiation, as they may be more accustomed to power differences simply determining outcomes.

National culture has also been shown to have an impact on manufacturing and supply chain practices, which can be useful to consider in a variety of contexts: analyzing manufacturing footprints, managing multi-plant operations, assessing competitors and suppliers and different countries, and so on. Consider the adoption of quality management practices. One European study indicates that in cultures with low *power distance* and *uncertainty avoidance*, implementation of formal quality management systems may require external market pressure, versus internal management initiative.<sup>57</sup> Higher *power distance* scores are

also associated with companies purchasing rather than manufacturing in-house a larger proportion of inputs for products they make.<sup>58</sup>

Finance is an area where one might expect rather limited cultural influence, and indeed *power distance* has not been researched heavily in this function. Among other dimensions, *uncertainty avoidance* has been linked to greater reliance on bank finance.<sup>59</sup> *Power distance*, however, has been researched in the related area of Accounting. Hofstede wrote that, "In large *power distance* countries, the accounting system will be used more frequently to justify the decisions of the top power holder(s); in fact it usually is their tool to present the desired image, and figures will be twisted to this end."<sup>60</sup> Subsequent research, however, has cast doubt on the impact of *power distance* on accounting disclosure, but does indicate that high levels of *uncertainty avoidance* do fit with disclosure and conservatism in accounting.<sup>61</sup>

Finally, there are important organizational or human resources implications of national culture. In countries with high (versus low) *power distance*, employee selection tends to give more emphasis to social class (over education), training tends to emphasize conformity (versus autonomy), evaluations focus on compliance or trustworthiness (over performance), wage differences between managers and workers are larger, leadership is more authoritarian (instead of participative), motivation is based on the assumption that subordinates dislike work and hence is more coercive (rather than assuming employees like work and trying to strengthen their motivation through intrinsic and extrinsic rewards), and organizations are more hierarchical (versus flat).<sup>62</sup> Managers who wish to achieve significant change in high *power distance* cultures are advised to put senior staff front and center in communication efforts, use legitimate authority, and "tell subordinates what to do." In contrast, in lower *power distance* cultures, it is more important to explain the reasons for change, "allow for questions and challenges" and involve employees in figuring out how to implement the desired change.<sup>63</sup>

### **Managing Adaptation to Cultural Differences**

We have seen that operating in ways that are congruent with their cultural contexts can improve business performance. So, it's clearly a bad idea to simply ignore cultural differences. For multinational companies, some variation in operating practices across locations is normally required. And as companies push farther with variation across locations, complementary moves such as decentralization of decision-making and indigenization of in-country management teams can support a company's ability to be responsive to local conditions. But simply varying practices everywhere to maximize congruence and pushing all important decision-making authority down to the country level or below isn't a very good idea either, because the result is likely to be a tremendous amount of costly complexity. At the extreme, a multinational becomes so localized that it gives up all of its potential international synergies and performs no better (and perhaps even worse) than a series of separate local firms would. So, managing adaptation (to cultural as well as other types of differences) entails finding ways to limit the need for and/or cost of variation.

Focusing on cultural similarities is one way to reduce the need for variation. The simplest way to do this is by focusing operations on locations with more similar cultures. Focusing on serving members of a company's home country's diaspora can ease entry into new markets by reducing the cultural distance that has to be crossed to reach local customers. Internally, using expatriates (typically from the company's home country) in particular roles also represents a type of focus. Employing an expatriate as country finance chief reduces the scope for potential culture-related misunderstandings around sensitive financial matters, and reflects the patterns of trust we have reviewed.

Externalization, e.g. via joint ventures, is a way that companies can reduce the cost of adapting to local cultures. Partnering with a local firm can provide access to local cultural understanding, business networks, and so on, that would be costly and time-consuming for a foreign company to develop on its own. As long as the partners can set up an effective interface to address cultural (and other) differences in managing the partnership, broader cultural congruence can be improved. Moving beyond joint ventures, companies can acquire foreign firms, gaining access to local knowledge and networks as well as direct

managerial control but requiring acquiring firms to have sufficient cross-cultural capability to manage and in most cases integrate acquired firms.

Another approach to reducing the need for variation is to promote a strong corporate culture. By attracting and cultivating employees and customers who are drawn to a particular corporate culture, the need to respond to national cultural differences might be reduced. However, it's important not to place too much confidence in a typical corporate culture overpowering national cultural differences. Recall that Hofstede's original research took place within a single company - IBM - and still revealed large cultural differences. Furthermore, research by Andre Laurent indicates that bringing employees from different cultures together in the same company might actually strengthen rather than mitigate national cultural differences among them.<sup>64</sup>

More broadly, an organization can also improve its capabilities for bridging cultural differences. Hiring for adaptability and investing in cross-cultural training can improve workforce capabilities and flexibility. Exposure to and deeper experience with foreign locations and cultures via participation in international teams, travel, and expatriation can inform and grow these kinds of capabilities. For many companies with high growth targets in foreign markets, increasing the diversity of their management teams should also be a priority. However, firms currently make only little use of this source of cultural capability. Of the 2008 *Fortune* Global 500 companies, only 14 percent had a nonnative CEO.<sup>65</sup> And among the directors of U.S. S&P 500 companies in 2008, only seven percent were foreign nationals, only 9 percent had degrees from non-U.S. institutions, and only 27 percent had any international work experience.<sup>66</sup> Most firms from emerging markets have even less internationalized leadership teams.

In thinking through decisions about how far to push efforts to adapt to local cultural conditions, it's also important to account for industry characteristics that increase or decrease sensitivity to cultural differences. Generally, businesses that sell directly to consumers (rather than to other businesses) are less sensitive to cultural differences. Service industries are generally more sensitive to cultural differences than industries focused on selling physical products. Thus, while they sell to other businesses, most kinds of IT services are highly sensitive to language differences. In contrast, industrial machinery (sold to other companies for use in their factories) tends to be relatively insensitive to cultural distance. This is one factor that helps explain the global success of Germany's relatively small *mittelstand* firms in many such sectors even though they have fewer resources for cultural adaptation than larger firms.

## 5. Conclusions

Cultural differences remain persistent and present an array of challenges for multinational companies. Firms that manage adaptation effectively are able to achieve congruence in the various cultures where they operate while extending their main sources of advantage across borders, and in some cases even making cultural diversity itself a source of advantage. While this note has emphasized cultural differences, which are often underappreciated, it's equally important to take note of cultural similarities. High and low *power distance* cultures, for example, both reflect responses to common challenges around how human beings should properly interact with each other in the face of inevitable differences in the power they hold in particular contexts. In managing adaptation, as well as more broadly, there's also a great deal to be gained by focusing on what unites us rather than what divides us.

## Exhibit 1

## Hofstede's Cultural Value Scores for 30 Selected Cultures

Country	Power Distance	Individualism/ Collectivism	Uncertainty Avoidance	Masculinity/ Femininity
Argentina	49	46	86	56
Australia	36	90	51	61
Brazil	69	38	76	49
Canada*	39	80	48	52
Chile	63	23	86	28
China	80	20	30	66
Colombia	67	13	80	64
Denmark	18	74	23	16
France	68	71	86	43
Germany	35	67	65	66
Greece	60	35	112	57
Indonesia	78	14	48	46
India	77	48	40	56
Iran	58	41	59	43
Israel	13	54	81	47
Italy	50	76	75	70
Japan	54	46	92	95
Korea (South)	60	18	85	39
Malaysia	104	26	36	50
Mexico	81	30	82	69
Netherlands	38	80	53	14
Philippines	94	32	44	64
Poland	68	60	93	64
Portugal	63	27	104	31
Russia	93	39	95	36
Singapore	74	20	8	48
Spain	57	51	86	42
Sweden	31	71	29	5
United Kingdom	35	89	35	66
United States	40	91	46	62
Mean	58.4	49.0	64.5	50.2
Median	60	46	70	51

Source: Geert Hofstede, *Culture's Consequences: International Differences in Work-Related Values*, 1980, Beverly Hills, CA: Sage.

\*English-speaking part

Exhibit 2

Cultural Profiles Based on Hofstede’s Cultural Dimension

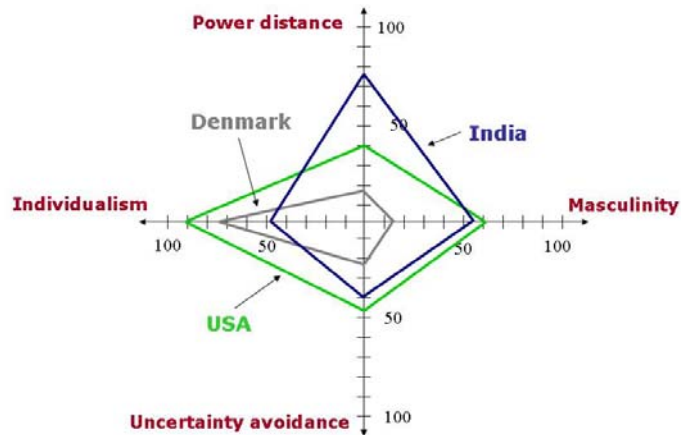


Exhibit 3

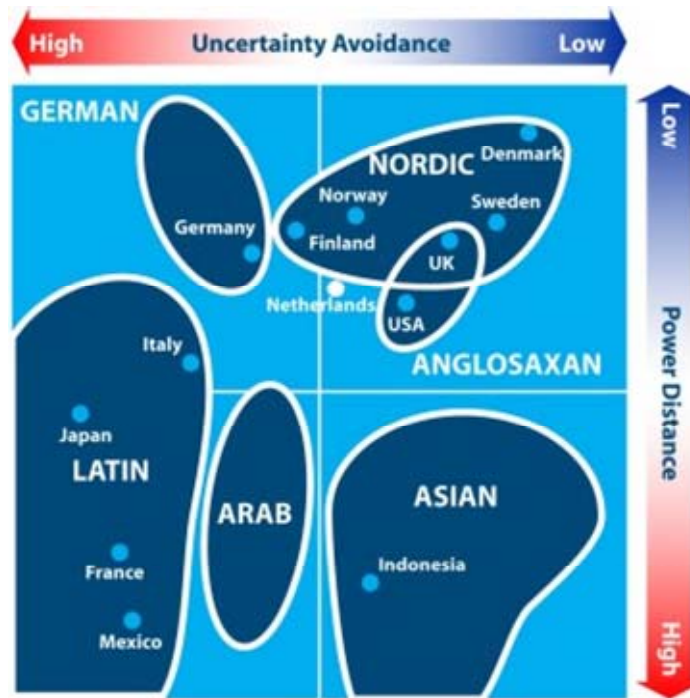
Linguistic Distance from English

Country	Primary Language	Secondary Language	Measure (wt.avg)	Country	Primary Language	Secondary Language	Measure (wt.avg)
Argentina	Spanish		3	Korea	Korean		4
Australia	English		0	Malaysia*	Malay		7
Austria	German		1	Mexico	Spanish		3
Belgium*	Flemish	French	1/3(1.7)	Netherlands	Dutch		1
Brazil	Portuguese		3	New Zealand	English		0
Canada*	English	French	0/3(0.9)	Norway	Norwegian		2
Chile	Spanish		3	Pakistan	Panjabi	Sindhi	3/3(3)
Columbia	Spanish		3	Panama	Spanish		3
Costa Rica	Spanish		3	Peru	Spanish		3
Denmark	Danish		2	Philippines*	Tagalog	Cebuan	7/7(7)
El Salvador	Spanish		3	Portugal	Portuguese		3
Ecuador	Spanish		3	Singapore*	Taiwanese		6
Finland	Finnish		4	South Africa*	Afrikaans	English	1/0(0.6)
France	French		3	Spain	Spanish		3
Germany	German		1	Sweden	Swedish		2
Great Britain	English		0	Switzerland*	German	French, Italian	1/3(1.6)
Greece	Greek		3	Taiwan	Taiwanese		6
Guatemala	Spanish		3	Thailand	Thai		7
Hong Kong	Cantonese		6	Turkey	Turkish		4
India*	Indo-Aryan	Dravidian	3/5(3.7)	US	English		0
Indonesia	Bahasa	Javanese	7/7(7)	Uruguay	Spanish		3
Iran	Farsi		3	Venezuela	Spanish		3
Ireland	English		0	Yugoslavia	Serbo-Croatian	Slovenian	3/3(3)
Israel	Hebrew		5	Arabic countries	Arabic		5
Italy	Italian		3				
Jamaica*	Creole		1				
Japan	Japanese		4				

\* Language ambiguous countries = a substantial portion of the population is bilingual

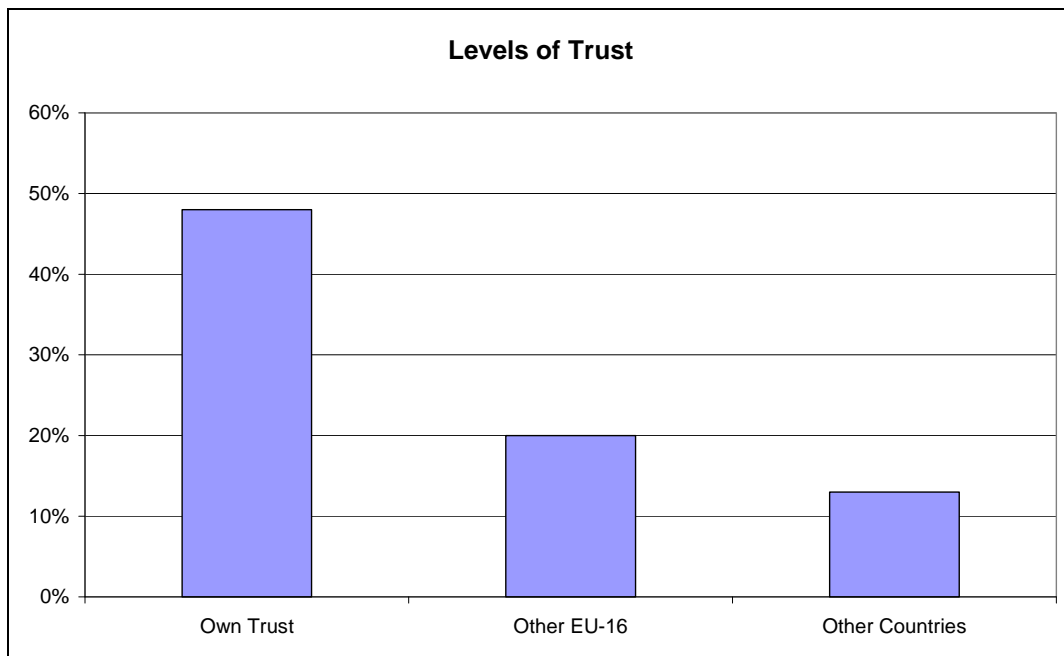
Source: Joel West and John L. Graham, "A Linguistic-based Measure of Cultural Distance and Its Relationship to Managerial Values," Management International Review, vol. 44, no. 3, 2004, p. 249 (Table 1).

Exhibit 4  
Synthesis of Country Clusters



Source: "Integrated Land-Use Management for Sustainable Development" Stig ENEMARK. April 2007, p 6. See figure 2 The Cultural Map of the world. Adapted form Gert Hofstede, 2001

Exhibit 5  
National vs. International Trust



Source: Based on a previous version Luigi Guiso, Paola Sapienza, and Luigi Zingales, "Cultural Biases in Economic Exchange?" *Quarterly Journal of Economics* 124, no. 3 (August 2009): 1095-1131 downloadable at [http://economics.uchicago.edu/download/cultural\\_biases.pdf](http://economics.uchicago.edu/download/cultural_biases.pdf).

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