

The Impact of Cultural Distance on MNEs' Performance: Focusing on "China-Specific" Capabilities of TMT*

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Extant studies have proposed that cultural distance is closely related with performance of multinational enterprises (MNEs). Based on the literature, this research explores the research questions when and how MNEs' liability of foreignness caused by cultural distance can be mitigated with *locally capable* top management team (TMT). In particular, the paper proposes three China-specific interactions, 1) *returnee manager*, 2) *educational background*, and 3) *political connections* of top management team. With data on 102 foreign-invested enterprises in China, this research finds positive moderating roles of TMT which possesses China-specific local capabilities. The implication of the study is that cultural diversity between two different country contexts is an important obstacle for the performance of MNEs and those with oversea-experienced, highly-educated, and politically-connected TMT managers can relieve this disadvantage. Our studies may contribute to the management studies by providing practical tools to avoid liability of foreignness in emerging market.

Key Words: Cultural distance, China-specific capability, returnee, education, political connections

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1. Introduction

The study of cultural differences between the home country of MNEs and their countries of operation has gained a broad interest in international business research (for the review, see Shenkar, 2012). While numerous empirical studies focus on the impact of cultural distance on MNEs performance, existing studies provided mixed empirical evidences regarding the specific influence of cultural distance (Brouthers

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and Brouthers, 2001). Whereas some studies have provided a negative relationship between cultural distance and MNE performance (e.g., Luo and Peng, 1999), other works have argue a positive effect (e.g., Morosini et al., 1998). Further, little research has directly examined the role of host-based institutions, which may influence the impact of cultural distance between home and host countries. For instance, as Hutzschenreuter and Voll (2008) indicated, local environment (Luo and Peng, 1999) and institutional difference (Ghemawat, 2001) in host countries are understudied in the distance context. Therefore, the concept of cultural distance should be investigated in the lens of local institutions (Gemawat, 2001). Culture provides a society's characteristic profile with respect to norms, values, and institutions that affords understanding of how societies manage exchanges (Hofstede, 1980; Trompenaars and Hampden-Turner, 1998). In the host country perspective, liabilities caused from cultural difference can be relaxed when MNEs have local-based and institutional capabilities. In this paper, we specifically emphasize that consequence of cultural distance in the context of MNE operation is function of locally-embedded institutions. Thus we investigate not only the direct effect of cultural distance on the MNE performance, but also examine the interaction effect of local moderators in China. Few attempts have made to bring these two factors (i.e., cultural distance and MNEs' local-based and institutional capabilities) together. Aligned with recent findings in the MNEs literature (for review, see Collins and Clark, 2003), we propose that psychic barrier caused by cultural distance can be mitigated by institutional superiority of TMT organization in the host countries. A wealthy of earlier researches have argued that organizational performance can be said as the reflection of the strategic decision-makers, namely top management team (Carpenter et al., 2004). Particularly, MNE can gain the institutional competence by utilizing locally competitive TMT, who can better respond to the local culture, institution, specific demand by local customer, and have advantage in selecting and managing local employees (Song et al., 2013; Rosenzweig and Noria, 1994). Empirically, the executives generally judge situation and circumstance of enterprise through their own individualized perspectives, based on their local experiences, values, educational background, competence, personalities and mental environment, and that when strategic situations arise they make strategic decisions depended on these unobservable psychological constructs. The localized managers of MNE in culturally distant contexts are also able

to be in a dominant position of local environmental state of market, economy, institution, society, culture as well as political system, so in this condition, those capabilities, experience and background of them are more likely to play an important part on moderating MNE performance. Some related literatures have paid attention on the associations of individual characteristics, especially for the top manager (CEO), with cultural distance problem. However, most studies were silent on the characteristic diversities of top manager teams that might also act on moderating the influence made by cultural differences. Thus, this study tends to lay stress on the interactions of the cultural distance with the locally competitive TMT members, involving oversea experience (i.e., returnee), educated background and political state, ultimately reflecting on the MNE performance. Generally speaking, first, returnees who had studied and/or worked in other countries and then returned to their home countries plays an important role of filling institutional gap between home and host countries. It has been argued that returnees, with their advanced technological and managerial skills and more importantly with local knowledge, would help to overcome liability of foreignness in the host countries and thus to promote the firm performance. Second, a lot of studies provide evidences that highly educated top executives possess rich local and global knowledge, information and social capital, which could also be conducive to improve the performance of the firm (Gottesman and Morey, 2006). Furthermore, there is also a growing number of literatures on the implications of the significance and value of political connections in the business field, which is particularly important under Chinese context. It has been also argued that political connections can help firms access to some local resources in the host countries, which ultimately increases the competitive value of firms (Fisman, 2001) or improves their performance. This study systematically investigates the influence of TMT members' characteristics, oversea experience (i.e., returnee), educational background, and political state. This paper particularly focuses on the top manager team (TMT), which is made up of senior-level executives of an organization, rather than only on the top manager (CEO) just like most of prior papers did (Park and Lee, 2004; Lee, 2013). They are agents for the corporation, appointed by board of directors, responsible for determine the overall direction of firm and nailing down that principal organizational objectives are achieved. Their leadership can be extended over the whole organization or for specific

divisions such as marketing, human resources, finance, strategy or operations. Additionally, this study is aimed at the MNEs operating in China as host country. As an emerging market, China has a highly complex social environment, a distinctive market environment as well as a particular political system (Shenkar and Von Glinow, 1994), under the context of which, research questions will be explained in a specific way, and those variables stated above will be more meaningful to investigate and research. Our study selected 102 listing MNEs from online stock trading system, including multinational subsidiaries and foreign-funded enterprises operating within China, used “Moderated Regression Analysis” to test these arguments by utilizing three important dimensions of firm performance: ROA, net margin and operating margin.

II. Theory and Hypotheses

2.1 Cultural distance

Differences in country-level culture contexts have been regarded as an key issue in the study of MNE strategies and organizational area (Brouthers and Brouthers, 2001). In MNE context, the concept of cultural distance is largely studied for 1) MNE performance (Reus and Lamont, 2009; Tihanyi, Griffith, and Russell, 2005; Ahammad et al., 2016; Hutzschenreuter et al., 2014), 2) entry mode choice (López-Duarte and Vidal-Suárez, 2010; Shenkar, 2012; Kim and Park, 2009), 3) learning across national borders (Barkema et al., 1997; Zeng et al., 2013) (see the review paper, Stahl and Tung, 2015). More recent studies try to link between cultural distance and 1) knowledge management, 2) exit decision 3) foreign creative tasks. For instance from the knowledge perspective, Qin et al. (2017) suggested that cultural distance between China and the home countries of MNEs hampers knowledge performance. And Lew et al. (2016) and Powell (2017) argued that cultural distance negatively affects the development of trans-specialization understanding in international technology alliances related to the knowledge transfer. Sousa and Tan (2015) focus on the exit behaviors and argued that cultural distance has moderating impact of international performance

on the exit decision (Sousa and Tan, 2015). Firm performance related with cultural distance is also variously investigated. Chua et al. (2015) argue that cultural distance between the innovator's and the audience's country is related with innovation crowd-sourcing work. And Azar and Drogendijk (2015) and He (2015) emphasize on the export performance in that adoption of innovations in response to uncertainties resulting from cultural distance to a foreign market is positively associated with a firm's export performance. Among them, MNE performance is regarded as function of liability of foreignness (Zhou and Guillen, 2015; Song and Yoon, 2008; Lee, 2008; Kim and Kim, 2014; Shen and Rhee, 2015). It has been argued that there are strong forces within nations to generate and maintain a common shared culture (Hofstede, 1980; Lee, 1998), which may cause an additional burden on foreign firms (Schwartz, 1999). When exploring the key role of cultural distance, extant studies argue that, with the cultural differences between the home- and host-country increasing, the capability of the MNE to perform effectively in the host market would decrease (Gomez-Mejia and Palich, 1997). Increased business difficulties resulting from cultural distance are caused from the unfamiliarity of the social customs, values, and institutions that afford environmental change across different markets. The outcome of MNE business has often been a main research issue, moreover a growing number of researches regard cultural distance in the MNE activities of operations as an important determinant of firm performance (Lee, 1998; Palich and Gomez-Mejia, 1999). Due to that, some researchers proposes that operating business under conditions of higher cultural distance is leading to a lower performance for MNEs (Chang, 1995), mainly because that greater cultural distance will bring about larger uncertainty of local environment, a higher risk and information asymmetry between the headquarters and the subsidiaries.

Specifically speaking, uncertainty describes a situation involving limited knowledge and/or unknown information, in the context of this paper, it refers to a lack of knowledge for MNEs about local cultural environment and situation of host country. While risk implies a state of uncertainty where some possible outcomes have an unexpected effect or significant loss, in this work, for an MNE operating in an unfamiliar country, it means the potential of encountering some unexpected events and losing something valuable. Following from transaction cost theory, firm should cut cost down to a largest extent in order to pursue a better performance, while the uncertainty, and

potential risk derived from cultural distance in cross-national business can increase a wide range of transaction costs for the operation in a new environment, such as psychological cost, opportunity cost and risk cost. For example, high cultural distance can decrease MNE performance owing to increased management cost, such as training, monitoring, and control costs of employment. Additionally, except the direct losses when faced with risks, MNEs could be less aware of the potential risks or opportunities because of the unfamiliarity with the environmental state of host country, which might also result in a certain extent of cost and losses. Moreover, information asymmetry can be referred to as information failure, it implies one organization possesses more or better information than the other, in this paper, there is a lack of balance regarding the information between headquarters and subsidiaries of MNEs. So, as cultural distance increases, generating information asymmetry in MNE may lead to a problem about that the complete and accurate information about subsidiary actions and performance would become more expensive and difficult to obtain, therefore it will be harder and higher-cost for the headquarters to interfere and make control on the behaviors and outcomes of subsidiaries. Thus based on transaction cost theory, due to these factors, cultural distance can immediately make influence on the performance of MNE. The basic hypothesis of this study about the relationship between national cultural distance and the performance of MNE can be proposed as following:

Hypothesis 1: The larger cultural distance between home- and host-country is negatively related with MNEs' performance.

2.2 Oversea education (Returnee)

Returnee can be defined as the people who had studied and/or worked in other countries, and then returned to their home countries (Li, 2012). It has been argued that returnees, with their advanced technological and managerial skills accumulated in the developed countries (normally Western countries), can fill important managerial and technological gaps in developing countries. Particularly, there is earlier literature (e.g., Lee and Sukoco, 2010; Tsang, 2002) have laid emphasis on how managers with overseas experience perform in cross-national organizations, and found they have a

particular and useful role in firm management and operation, but few papers have focused on or just refer to how returnees interact with cultural distance in MNE subsidiaries in host country. In this study, we propose that the distinctive features of returnees can be very critical for obtaining local cultural and marketing tacit knowledge and are able to act as a significant role of 'bridge' between MNEs and local environment, which can help to mitigate the liability of the foreignness of MNEs in multi-cultural contexts.

To an MNE, the primary advantage and trait of returnees is the possession of knowledge about the culture of both home country they grown up and a foreign developed country they have studied in. First, in terms of the local knowledge, returnees in MNEs are able to use two languages, and possess a complete understanding of the local cultural environment, market state, situational policy as well as political systems of host country. Undoubtedly, in multi-national contexts, their cultural background and local knowledge enable them to deal with local environment more directly and effectively. So, by utilizing returnees, foreign firms can gain local technological, cultural and marketing tacit knowledge in emerging countries (Liu et al., 2014), and such knowledge can help to reduce the uncertainty of local environment derived from cultural differences, and thus may reduce the probability of risk events, or help MNEs respond timely and correctly when arising risks or recognizing opportunities, which is an important determinant of firm performance.

Second, the experiences accumulated in foreign countries enrich returnees with global perspective, multiple-cultural knowledge, cross-cultural communication skills as well as absorptive capacity of external knowledge. Due to that, they can act as a 'bridge' in an MNE between foreign expatriates from home country and local talents, between foreign parent firms and local firms in their home country, as well as between their firms and the multi-cultural environments that they operating in. This role of returnees is characterized by their inter-cultural capability and their ability to mediate transnational and local cultural contexts, and alleviate the tension between internal requirements within an MNE and local conditions in a host country (Kostova and Roth, 2002). They will facilitate the information exchange and communication both in internal and external environment of MNEs, which allow them to overcome the liability of foreignness, help reduce the cultural distance by the reduction of information

asymmetry in multi-contextual environments.

From a cultural integration perspective, the ability to integrate local knowledge stocks with international information, and diffuse them through their networks is their major competitive capability for an MNE (Gupta, and Govindarajan, 2002). Returnees can contribute to the achievement of this capability through their possession of advantages both in host country and foreign country, so the merged culture created by returnees through organizational cultural confluence can act on reducing the impact of cultural distance and boosting the firm performance.

Hypothesis 2: The negative relationship between cultural distance and MNEs performance is positively moderated by a larger proportion of oversea-educated managers (i.e., returnees) in TMT.

2.3 Education background

In China, education background is a very common, basic, and crucial indicator to evaluate the overall level of a person, and generally is the major selection item in recruitment of human resource management. Furthermore, highly-educated managers possess more local and global knowledge than those who with lower educational attainment (Wu and Olk, 2014). Existing literature suggests the importance of examining the top manager's education with perspective of upper echelon, for understanding a company's strategic activities and performance (Finkelstein and Hambrick, 1990; Hambrick and Mason, 1984). There is a large amount of evidence suggesting that a better education enables a better local understanding, and prior studies in the management literature suggested that managers with higher educational attainment equipped with superior abilities, knowledge and resources that may help to deal with local business (Papadakis and Barwise, 2002; Hogan and Warrenfeltz, 2003). Wiersema and Bantel (1992) has shown that education level of manager affects managers' attitudes about environmental changes and risk taking in the local market and is thus relevant to competitor identification (Wiersema and Bantel, 1992). However, there are limited studies consider education level of managers as an individual variable in international business researches, few have associated it with national

cultural distance of MNEs. Originally, our research considers the degree of education background of top managers as an influencing factor of the impact created by cultural difference between host country and home country on the performance of MNEs. The high-level education experience can qualify a manager with professional skill and knowledge, broad perspective, as well as strong learning ability, cognitive abilities, excellent acceptance, and absorptive capability of the unfamiliar culture and information in a new environment. As Dunbar and Katcher (1990) indicated, better local knowledge can be a function of education and training level of managers. Thus, a higher education level of managers can not only directly act on shortening the cultural distance within an MNE, but rather play a role on overcoming liability of foreignness of MNEs with their superior local adaptation and learning capabilities. More specifically, highly educated manager experience can adapt themselves to such a mixed cultural environment more rapidly and effectively in an MNE, and are able to perform and respond better when recognizing opportunities and encountering risk events. There are also indications that education background is positively related to the managers' social capital. That is, managers with higher educational profiles may enjoy more and higher level social ties (relationship network) to some other senior talents and government officials. Especially in China, there is a phenomenon that some managers would choose to study for a higher degree for expanding their networkings during that period. The literature suggests that personal connections of top managers can help enterprises build connection networks with important external local constituents (Li et al., 2007). These connection resources of high educated managers in an MNE may promote the degree of intimacy with local cultural environment of host country, and meanwhile, when a risk event occurs, these social ties may also provide better solving countermeasures for the operation of an MNE.

Besides, the study defines educational background by the level of educational attainment, now with the progress of society and the intensity of talent competition in China, Bachelor's degree can be considered as a basic level of academic qualifications, and it is also a common phenomenon for university graduates to study for a Master's degree. So, to enhance the significance of this moderator, this study only regards Doctorate, which is the relative highest and possible academic degree with no doubt, as the higher education level here.

Hypothesis 3: The negative relationship between cultural distance and MNEs performance is positively moderated by a larger proportion of highly-educated managers in TMT.

2.4 Political connection

Extant literature (e.g., Chang et al., 2012; Quer et al., 2012) insists that impact of cultural distance is the function of interaction between firm and government. Especially in the emerging markets where government wield strong influence on business environment, government factor is very critical to characterize the impact of cultural distance. Large amount of literature had explored the implications of political connections in the business world. It has been found that political resource or capability help firms to secure favorable regulatory conditions (King, 2015; Agrawal and Knoeber, 2001) and access to key resources such as bank loans (Faccio, 2006), which enhance the value of firms (Fisman, 2001). Due to his study is focusing on the MNEs operating in China, it is necessary to stress that despite growing by leaps and bounds, China is still during in the stage of transition economy with a less developed emerging market, a weak institutional environment, as well as an incomplete legal system. A prior research argues that the role of political connections is more crucial to an enterprise in an environment of transition economy than it would be in a mature and developed market, because of institutional features (Li et al., 2008). Therefore, in the case of China, it has been proposed that maintaining close ties with the government or ruling party can significantly help private enterprises to overcome some obstacles or failures among markets, legal or institutional matters (Choi, et al., 2017; Liu et al., 2016). Given the most critical and decisive roles of top level managers in an enterprise, the political status of them will be an effective influencer on enterprise management, that is considered as an another key moderating variable in this paper.

Due to the unique political environment in China, membership of Communist Party implies a political power, more importantly, and represents an important affiliation with the only ruling party within China (Li et al., 2008). Particularly in China, communist party dominate in the process on deciding economic policy as well as political strategy. Existing literature argues that the core channels by which firms establish

political relations with the government are membership of the National People's Congress or the CPPCC, which has an informal reporting relationship with the government, and former government officials with a recessive reporting relationship with the government. Political relationships established through a member's channel are stable, long-term, and authoritative (Li et al., 2008). In most instances, Communist Party relationship has often been linked with state-owned enterprises (SOE), but there is an increasing number of researches have paid attention on the association of Communist Party relationship with foreign invested enterprises, and it have found that the impact of Party membership on firm performance is fairly significant in developing regions or markets (China). However, few have ever referred this factor as a relevant factor with the research question about cultural diversity problem. Thus, one more task of this study is to examine whether and how political status—Chinese Communist Party membership (CCP)—of top managers related with the association of culture distance with MNE subsidiaries performance.

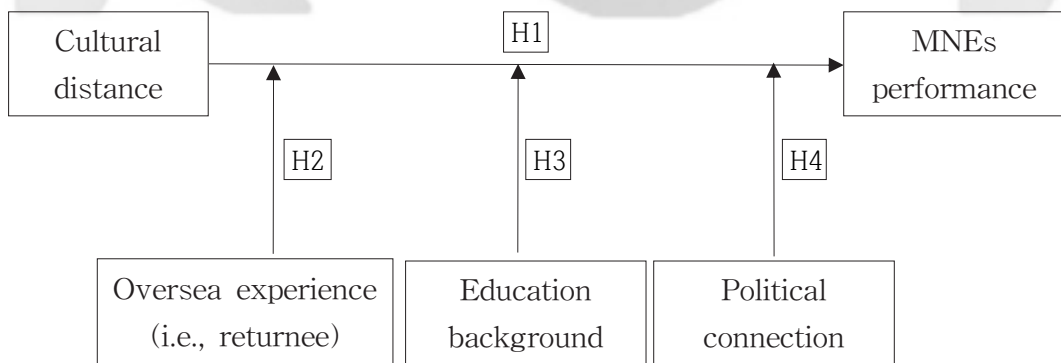
Managers with party membership possess distinct advantages in many respects in comparison with non-Party people (Choi, 2011). On the one side, in the internal aspect of personal quality, the criteria to join the Communist Party that applicants have to fulfill is pretty strict, some sociologists (Walder, 1995) even regard Party membership as a certification much like educational attainment. Specifically, to become a Party member, an applicant needs to show great learning ability, a spirit of solidarity, good interpersonal skills, great persistence quality, and a affirmative attitude toward government, workplace, and the communist ideology. In addition, after economic reform in the late 1970s, an important change in the selection standard of Party members is the increasing emphasis on the educational background and expertise of applicants (Bian et al., 2001). As a result of this change, Party members are now generally younger and better educated than in the past. Depend on these excellent characters, this paper supposes that, when cross-national enterprises encounter difficulties or risk events derived from the cultural differences during the operation in the host country, China, managers with the status of a Communist Party membership could in general outperform those normal people without Party membership.

On the other side, in the external aspect of resources possession, managers with party membership can get a more comprehensive understanding about local political

and institutional environment of host country, which can help MNEs mitigate the sense of strangeness to local cultural environment. This character of managers could reduce the information uncertainty resulted from operating in a different cultural country to a great extent. Furthermore, through participates in the party activities, they may possess a wider social communication circle, through which a special relationship network and a set of 'unhealthy' ties – 'guanxi' can be achieved. 'Guanxi' is often considered to be the source of key competitive advantage for foreign companies doing business in China. This special resource may promote the relatedness of an MNE with local cultural environment of host country, and these political ties may also provide insurance and convenience for the operation of an MNE to resist the risk resulted from cultural differences. So, this study will consider this special resource can help reduce the negative connection between cultural distance and subsidiaries performance. The hypothesis about the political status can be supposed as following:

Hypothesis 4: The negative relationship between cultural distance and MNEs performance is positively moderated by a larger proportion of managers with party membership in TMT.

〈Figure 1〉 Theoretical Model



III. Methodology

3.1 Sample and data

To test these hypotheses, the sample selected in this study contains 102 foreign-invested enterprises (FIE) operating in China and listing on B-share market. These FIEs are from 18 foreign countries as summarized in table 1. The types of FIE may include equity joint ventures (EJV), wholly-owned foreign enterprises (WFOE), cooperative joint ventures (CJV), and foreign-invested companies limited by shares (FCLS), which are identified into two categories: joint venture (JV) and wholly-owned subsidiary (WOS) in this paper.

〈Table 1〉 The statistics of cultural distance for MNEs

	Home country	N	Cultural distance
1	Australia	1	85.45
2	Canada	3	76.16
3	France	7	80.06
4	Germany	3	73.89
5	Holland Netherlands	1	92.72
6	Hong Kong	34	15.84
7	India	1	31.51
8	Indonesia	1	27.64
9	Italy	1	77.96
10	Japan	4	77.70
11	Korea	2	64.48
12	Malaysia	1	30.07
13	New Zealand	1	85.26
14	Singapore	6	29.05
15	Switzerland	1	72.25
16	Taiwan	17	49.55
17	UK	8	82.53
18	USA	10	83.14
	Total number of obs.	102	

The data of these 102 FIEs was collected from an online stock trading system on 58 indicators that can be classified into 2 levels, firm-level and top manager team level. Firm-level data contains some basic profiles and financial information of MNE, such as firm age, firm size, home country, cultural distance with host country (China), and financial information. Top manager team-level data contains the composition features of top manager team members, such as the number of total members, returnee members, high educated members, party membership members, etc.

3.2 Measurement

3.2.1 Dependent Variables

This paper utilizes financial performance to describe firm performance, measured by ROA, net margin, and operating margin. ROA is defined as net income divided by total assets, and it shows the percentage of how profitable a company's assets are in generating revenue. Net margin is defined by the ratio of net profits to revenues for a company, giving an accurate view of how profitable a business is. Operating margin, also known as the operating profit margin or ROS is a margin ratio used to measure a company's business strategy and operational efficiency. It describes the performance of a company by analyzing the percentage of total revenue that is converted into operating profits.

3.2.2 Independent Variables

There is only one major independent variable, the degree of cultural differences between home country of MNE and China. It is calculated by Hofstede's (2001) cultural value scores based on four dimensions (i.e., power distance, uncertainty avoidance, individualism, and masculinity). Cultural distance is measured as the aggregate differences over these four dimensions between home country and host country scores, where China is the host country for all the firms in the sample. Based on the literature (Manev and Stevenson, 2001; Kim and Gray, 2009), Cultural distance was computed as a Euclidean distance. The following formula was used:

$$CD_j = \{\sum_i (I_{ij} - I_{ic})^2\}^{1/2}$$

where:

CD_j : Cultural distance between the j country and the China.

$I_{ij} - I_{ic}$: The difference of Hofstede's score in the i cultural dimension between the j country and the c country where the China is.

3.2.3 Moderating variables

As the core researched content of the study, there are three variables about the diversity of top manager team moderating the main effect of cultural distance on MNE performance, including the proportion of returnee members, highly educated members as well as Communist Party membership in a TMT. Specifically, as shown previously, our study considers people with oversea education as returnee, which has been defined as the people who had studied in other countries, generally refers to some developed countries such as the U.S., and then returned to their home countries (Li, 2012). As a moderating variable, the proportion of returnees in a TMT is calculated by dividing the number of returnees by the total number of TMT members. Similarly, as mentioned earlier, due to the current development situation of talent resource market in China, only doctor's degree is considered as the higher education experience in our study, so the proportion of high-level educated members in TMT is measured by dividing the number of members with a doctorate by overall number of TMT members. Additionally, in China, Communist Party membership implies a measure of political status. So, one more moderator is the membership in Chinese Communist Party (CCP) in a TMT, calculated by dividing the number of party members in TMT by the total number of TMT members.

3.2.4 Control variables

The research controlled for several variables that could be the main driver of the firm performance. A plenty of empirical researches have stated that older firms can benefit from accumulated knowledge, experience, abilities and skills in all crucial aspects of the business management, which can address superior performance. So, our study controlled for *firm age*, calculated by subtracting the year of firm establishment from 2017 and plus 1. Compared to other countries, the business organizations operating in China are multi-industry and generally with a large size. (Keister, 1998: 409). To take into account this effect, the study included the total number of subsidiary's

employees as a control for firm size. Besides, the MNEs of the sample selected in this paper belong to the diversity of industries, which can be classified into three categories, manufacturing, service and construction. So, our study includes three dummy variables as controls for manufacturing industry, service industry and construction industry, respectively, where “1” is coded to indicate that the firm is in the manufacturing sector, service sector or construction industry and “0” is for all other industries. Furthermore, as for an MNE, entry mode choice is an important strategic decision and a determination of firm performance, refers to the initial preferences of MNEs when they decide to enter different foreign markets, generally including greenfield investment, joint ventures, and wholly-owned subsidiaries. So this study also controls firm entry mode as dummy variable, which was coded as ‘1’ if an MNE chose to enter Chinese market through a joint venture with a local partner, and ‘0’ for it through wholly-owned subsidiaries.

3.3 Analysis method

This study tested the hypotheses through moderated robust regression analysis, by which we can detect the main effects of independent variable – cultural distance, and also the interactive effects of moderating variables – the proportion of returnee members, highly educated members and the members with Communist Party membership in a TMT. For each of the dependent variables, the study estimated three models. Model 1 contains the effect of all control variables. Model 2 adds the basic effect of cultural distance, Model 3 adds the interaction of cultural distance with three moderating variables, and is also the full model of our research. These models can be presented as following equations :

$$\text{Model 1: } Y = \beta C + \beta_0 + \varepsilon$$

$$\text{Model 2: } Y = \beta_1 X + \beta_2 Zr + \beta_3 Ze + \beta_4 Zp + \beta C + \beta_0 + \varepsilon$$

$$\text{Model 3: } Y = \beta_1 X + \beta_2 Zr + \beta_3 Ze + \beta_4 Zp + \beta_5 X*Zr + \beta_6 X*Ze + \beta_7 X*Zp + \beta C + \beta_0 + \varepsilon$$

where:

Y : The financial performance of MNEs, including three dimensions, ROA, net margin, and operating margin.

C : Control variables, firm age, firm size, entry mode, industry categories.

X : Independent variable, cultural distance.

Z : Moderating variables (Z_r = returnees, Z_e = high educated members, Z_p = CCP members)

β_0 = the least-squares estimate of the intercept.

$\beta_1, \beta_2, \beta_3, \beta_4$ = the least-squares estimate of the regression coefficient for independent variable X , and moderators Z_r, Z_e, Z_p

$\beta_5, \beta_6, \beta_7$ = the least-squares estimate of the interactive regression coefficient for moderators Z_r, Z_e, Z_p .

ε = a residual term

IV. Result

Table 2 shows descriptive statistics and correlations between the variables used in our study. Unsurprisingly, ROA, net margin and operating margin are positively correlated with each other ($r = 0.736, 0.518$ and 0.957). And it also shows that cultural distance is negatively related with each of the performance dimensions ($r = -0.087, -0.112$ and -0.111). These expectant correlations among the independent variable and dependent variables set a foundation of this whole test, thus allowing us to validate the next step for the research.

Table 3 presents the regression results on ROA in Model 1a, 2a, 3a, Table 4 presents the results on net margin in Model 1b, 2b, 3b, as well as Table 5 shows the effect on operating margin in Model 1c, 2c, 3c. According to these tables, it shows that cultural distance has a significantly negative relationship with net margin ($b = -0.145, p < 0.05$, Model 2b) and operating margin ($b = -0.001, p < 0.1$, Model 2c), and is also negatively related to ROA in Model 2a, while the coefficient is not significant ($b = -0.023, n.s.$, Model 2a). These results confirm hypothesis 1, and suggest that, on average, as for an MNE, the cultural distance between home country and the country it operating in, China, generally is a problem on leading to a low financial performance.

Hypothesis 2 predicts that a TMT with a larger proportion of returnee members would reduce the negative impact of cultural differences on the performance in an

〈Table 2〉 Descriptive statistics and correlations

	Mean	S.D.	1	2	3	4	5	6	7	8	9	10	11	12
1. ROA	6.449	5.45	-											
2. Net margin	23.667	18.7	0.736	-										
3. Operating margin	0.153	0.149	0.518	0.957	-									
4. Cultural distance	48.546	28.103	-0.087	-0.112	-0.111	-								
5. The proportion of returnees in TMT	0.131	0.192	0.141	0.252	0.268	0.242	-							
6. The proportion of high-level educated managers in TMT	0.096	0.177	-0.084	0.135	0.218	0.172	-0.039	-						
7. The proportion of managers with party membership in TMT	0.102	0.226	0.037	-0.026	-0.07	0.041	-0.188	-0.024	-					
8. Firm age	21.358	6.744	-0.062	0.1	0.148	-0.071	-0.056	0.162	0.097	-				
9. Firm size (log)	7.772	1.512	-0.013	-0.188	-0.252	0.25	-0.138	0.094	0.133	0.054	-			
10. Entry mode (joint venture)	0.741	0.441	-0.098	0.047	0.079	-0.031	-0.067	0.256	0.146	0.006	0.144	-		
11. Manufacturing	0.691	0.465	-0.098	-0.271	-0.292	0.299	0.093	0.099	-0.189	-0.124	0.067	-0.09	-	
12. Service industry	0.259	0.441	0.038	0.27	0.323	-0.348	-0.037	-0.093	0.05	0.069	-0.158	0.157	-0.885	-
13. Construction industry	0.012	0.111	-0.022	-0.045	-0.057	0.004	-0.012	0.010	0.116	0.294	0.107	-0.189	-0.167	-0.066

MNE. This argument suggests that the interaction of cultural distance and the proportion of returnee members is positively related to MNE's performance. In support of this hypothesis, the results show that the interaction of cultural distance and the proportion of returnees members in TMT is significantly and positively related to ROA ($b = 1.209$, $p < 0.05$, Model 3a), and is also positively related to net margin in Model 3b and operating margin in Model 3c, while the coefficient is not significant ($b = 0.446$ and 0.007 , n.s.). Therefore, the findings support hypothesis 2 with respect to one dimension of firm performance.

Hypothesis 3 expects that an MNE with more managers with higher education background in its TMT would help to control the negative effect from cultural distance on firm performance, it suggests that the interaction of cultural distance and the proportion of high educated members in TMT is positively related to MNE's performance.

〈Table 3〉 Regression models predicting ROA.

	DV=ROA		
	Model 1a	Model 2a	Model 3a
Firm size	-0.000 (0.776)	-0.000 (0.556)	-0.000 (0.257)
Firm age	0.004 (0.956)	0.005 (0.948)	-0.014 (0.849)
Entry mode (joint venture)	-0.454 (0.699)	1.011 (0.362)	1.314 (0.221)
Manufacturing industry	-4.566 (0.110)	-2.627 (0.320)	-1.859 (0.470)
Service industry	-4.147 (0.163)	-2.835 (0.307)	-2.365 (0.378)
Construction industry	-4.342 (0.454)	-0.137 (0.979)	0.98 (0.845)
The proportion of returnees in TMT		5.351** (0.039)	4.805* (0.084)
The proportion of high-level educated managers in TMT		-2.655 (0.329)	-1.301 (0.660)
The proportion of managers with party membership in TMT		-4.177** (0.045)	-3.518* (0.091)
Independent variable			
Cultural distance		-0.023 (0.196)	-0.031* (0.077)
Moderators' interactions			
Cultural distance * The proportion of returnees in TMT			1.209** (0.015)
Cultural distance * The proportion of high-level educated managers in TMT			1.204** (0.019)
Cultural distance * The proportion of managers with party membership in TMT			0.316 (0.449)
Constant	9.598*** (0.004)	7.668** (0.015)	7.456** (0.015)
N	90	90	90

Significance levels: * p < 0.1 ** p < 0.05 *** p < 0.01

〈Table 4〉 Regression models predicting net margin.

	DV=Net margin		
	Model 1b	Model 2b	Model 3b
Firm size	-0.000 (0.459)	-0.000 (0.480)	-0.000 (0.202)
Firm age	0.048 (0.870)	0.084 (0.742)	0.009 (0.972)
Entry mode (joint venture)	-2.806 (0.523)	-0.825 (0.835)	-0.475 (0.902)
Manufacturing industry	-14.292 (0.167)	-25.872*** (0.006)	-25.778*** (0.005)
Service industry	-2.361 (0.826)	-17.735* (0.065)	-16.140* (0.084)
Construction industry	-17.474 (0.407)	-25.024 (0.166)	-22.679 (0.197)
The proportion of returnees in TMT		34.707*** (0.000)	35.955*** (0.000)
The proportion of high-level educated managers in TMT		3.099 (0.752)	2.200 (0.841)
The proportion of managers with party membership in TMT		-12.715* (0.077)	-14.010* (0.054)
Independent variable			
Cultural distance		-0.145** (0.020)	-0.175*** (0.005)
Moderators' interactions			
Cultural distance * The proportion of returnees in TMT			0.466 (0.788)
Cultural distance * The proportion of high-level educated managers in TMT			3.137* (0.086)
Cultural distance * The proportion of managers with party membership in TMT			3.003** (0.041)
Constant	32.314*** (0.008)	45.588*** (0.000)	48.354*** (0.000)
N	89	89	89

Significance levels: * p < 0.1 ** p < 0.05 *** p < 0.01

〈Table 5〉 Regression models predicting operating margin.

	DV=Operating margin		
	Model 1c	Model 2c	Model 3c
Firm size	-0.000 (0.250)	-0.000 (0.241)	-0.000* (0.098)
Firm age	0.001 (0.632)	0.000 (0.893)	-0.000 (0.823)
Entry mode (joint venture)	0.011 (0.734)	0.020 (0.507)	0.027 (0.371)
Manufacturing industry	-0.055 (0.473)	-0.157** (0.028)	-0.157** (0.029)
Service industry	0.050 (0.537)	-0.047 (0.523)	-0.037 (0.615)
Construction industry	-0.091 (0.563)	-0.124 (0.368)	-0.106 (0.436)
The proportion of returnees inTMT		0.229*** (0.001)	0.230*** (0.002)
The proportion of high-level educated managers inTMT		0.076 (0.330)	0.059 (0.498)
The proportion of managers with party membership in TMT		-0.158** (0.011)	-0.139** (0.026)
Independent variable			
Cultural distance		-0.001* (0.074)	-0.001** (0.030)
Moderators' interactions			
Cultural distance * The proportion of returnees in TMT			0.007 (0.568)
Cultural distance * The proportion of high-level educated managers in TMT			0.024* (0.091)
Cultural distance * The proportion of managers with party membership in TMT			0.022* (0.077)
Constant	0.133 (0.140)	0.259*** (0.004)	0.276*** (0.002)
N	84	84	84

Significance levels: * p < 0.1 ** p < 0.05 *** p < 0.01

To prove this hypothesis, the test of our study found that the interaction of cultural distance and the proportion of high educated members is significantly and positively related to ROA ($b = 1.204, p < 0.05$, Model 3a), net margin ($b = 3.137, p < 0.1$, Model 3b) and operating margin ($b = 0.024, p < 0.1$, Model 3c). Therefore, hypothesis 3 is supported with the definite consequences to each respect of firm performance.

Hypothesis 4 supposes that an MNE with more managers possessing Chinese Communist Party membership in its TMT would reduce the negative effect from cultural distance on firm performance. The last argument suggests that the interaction of cultural distance and the proportion of members with Communist Party membership has a positive relationship with MNE's performance. To confirm this hypothesis, the results indicate that the interaction of cultural distance and the proportion of Party members in TMT is significantly and positively related to net margin ($b = 3.003, p < 0.05$, Model 3b) and operating margin ($b = 0.022, p < 0.1$, Model 3c), and is also positively associated with ROA, while equally the coefficient is not significant ($b = 0.316, n.s.$, Model 3a). Therefore, the findings also support the last hypothesis with the clear result to two measurements of firm performance.

V. Discussion and Conclusions

5.1 Discussion of findings

With data on foreign-invested enterprises from various countries operating and listing in China, the study found that for such MNEs, cultural diversity between these home and host country contexts is an important obstacle to reach an expectant performance. And more importantly, the better local knowledge of top manager teams, which is affected by oversea experience, education background, and political connection, would act on controlling the effect created by cultural distance. This research validated these findings by utilizing several different measures of MNE's financial performance, including ROA, net margin and operating margin.

The result of this research regarding the impact of cultural distance on MNE performance

is well aligned with the findings of most earlier studies. For example, Luo and Peng (1999) argued a negative relationship between cultural distance and MNE performance. Other studies also proposed that doing business under conditions of higher cultural distance leads to lower performance for MNEs (Chang, 1995). When enterprises enter a cross-national market, uncertainty, information asymmetry and potential risk resulted from cultural diversity will cause them to suffer from a liability of 'foreignness'. Therefore, the majority of researches referring to the issue about cultural distance would generally pay their attentions on various consequences it could cause, with the exception of firm performance, also including the aspects of important organizational strategies and management structures used in the cross national business context, such as the decision of entry mode, international diversification, various localization strategies, and the employment preference. For example, high cultural distance has been related with low rates of joint venture failure (Park and Ungson, 1997), and it has been found that MNEs in manufacturing industry preferred joint ventures to wholly-owned subsidiaries as their mode of entry into uncertain markets (Brouthers and Brouthers, 2003). Moreover, there are some studies indicate that cultural distance increases the tendency of MNEs to hire expatriates from parent countries at the top manager, TMT, and workforce levels in overseas subsidiaries (Gong, 2003). However, this study puts more emphasis on the interactions of several other features about the employment of superior managers with cultural distance, which can be expanded to some tools that might help mitigate the liability of foreignness, including returnees, members with doctor's degree and Communist Party members. Most of previous studies fail to deal with interaction between cultural difference and locally-embedded factors especially in the emerging market. Strategic adapting local culture values may take place in the domain of local institutions such as nations' political economy, education, religion, and language of host country (Schwartz, 1999). However extant papers ignore the local market specific factors. Based on unique institutional factors in China, we link political background (e.g., party membership) and human resources (e.g., education and returnees) with cultural distance. The findings confirmed that the association of cultural distance with the proportion of returnee members in TMT is positively related to MNE's performance. It appears that a larger proportion of returnees in a TMT can help to control the negative influence made by cultural distance on MNE's performance.

Actually, in the field of international business research, “returnee” is not a fresh topic. However, more studies prefer to make comparison of them with local talents of host countries or even foreign expatriates from home countries, they wonder how returnees perform or who performs better in MNEs. For example, it has been indicated that returnees can effectively transfer both parent company knowledge to the subsidiary and local knowledge to the parent company, both of which will enhance performance (Wang, 2015). While our study regards returnees as a positive influencer of cultural distance that can mitigate the declining performance, and provide an empirical evidence to consider that having a certain proportion of returnees in TMT is a way to overcome the ‘liability of foreignness’, which can be proved on the MNEs’ performance. The findings also suggest that MNEs with higher level educated members in TMT can relatively perform better under the harmful influence made by cultural distance. Educational background, as a basic information of a person, is generally considered in the research about innovation, human resource management or the personal performance of CEO. While this study associated this variable with the issue about cultural distance, and proved that the interaction of them can significantly mitigate the declining performance. Furthermore, it is important to discuss the boundary of high educational level. In the earlier research, it has been roughly defined that CEOs with graduate degrees of universities were assumed to have higher quality educations than those without graduate degrees (Gottesman et al., 2006). However, the sample used in this study was selected from China, a country with a huge market, a rapidly developing society and a strong talent competition, in where Bachelor’s degree can be considered as a basic and initial level of academic qualifications that most of talents are satisfied. Moreover, the value and competitiveness of Master’s degree is also becoming weaker. Due to the universalization of Bachelor’s degree, a growing number of university graduates choose to participate in postgraduate entrance examination in order to get a Master’s degree, so, which is also a universal phenomenon in Chinese talent market. While Doctorate can be viewed as the relative highest possible academic degree beyond doubt, and the value of it is definitely rare and competitive. Thus for getting a more significant result to validate the hypothesis 3, this study only associated Doctorate as the higher education level here with cultural distance, and is as expected positively reflected on the MNEs’ performance. Finally, the findings also show that a larger

proportion of members with Communist Party membership in a TMT can positively moderate the negative relationship between cultural differences with MNEs performance. It suggests that the political connection of top managers can help MNEs rescue the sliding performance effect by the cultural distance. Among the previous research, it has been found that political connections can help increase the value of firms or improve their performance (Li H et al., 2008). As another important gap in the literature, this study links the diversity of political status in TMTs with cultural distance faced by MNEs. However, the relative magnitude of top managers' political connections likely varies across different emerging markets. Thus it is necessary to discuss that the cultivation of political connections is particularly important to private enterprises in transition economies such as China, where the government remains an important influence in strategic resource allocations. Through the political connection network, some unhealthy ties, *guanxi*, can be achieved, that is often said to be the source of sustained competitive advantage for foreign companies doing business in China. In contrast, Chinese cultural and institutional environment favoring '*guanxi*' likely explains the dominance of political connections among the advantages of Communist Party membership. Thus this study empirically demonstrates that the political relationship can not only provide value and improve the performance for private enterprises, but also mitigate the negative impact of cultural distance on MNEs performance.

5.2 Contributions and limitations

Cultural distance can be said as an inevitable problem when MNEs expand their business into new markets. And thus MNEs often seek to expand into markets with relatively familiar culture environment. However, extant findings between cultural distance and MNE performance is not clear and mixed at best. Our theoretical models strengthen on the contingencies, when or in what condition liability caused from cultural difference can be mitigated. Heterogeneity of managerial background and powerful government are distinct features of Chinese market. By considering these characteristics, our studies shed lights on better understanding emerging markets. As for practical point of view, our findings also shed important insights into the more general question of what management's local competencies can act on mitigating the harmful influence

made by cultural diversity on MNEs operating in China. Oversea experience, educational background and political connections, these three characteristics of TMT composition can be strategically utilized to achieve a better performance for MNEs operating in a foreign country. On the other hand, this research supplements the literature on the roles of returnees, higher educated managers and Communist Party members in MNEs. In addition to the value and resources provided by these talents own merits able to improve the firm performance, they can also play the roles in controlling and moderating the negative effect of cultural distance, therefore leading a better MNEs' performance. Thus our study contributes to this line of researches by providing practical tools to avoid liability of foreignness created by cultural diversity. Besides the contributions, our study also has several limitations. First of all, even though the sample of this study is the representative of MNEs in China, sample size is not large. Besides, only foreign MNEs listed in B-share market in China were analyzed in our study. Therefore, the generalizability of this study's findings to other MNEs operating in other countries is limited. And this study only focuses the role of local institutions with single country context and thus our finding is context-specific. Future studies can test the findings on a larger and multiple sample of the cross national business. The second limitation is that our measurements of management construct is based on the proportion of some certain specific members in TMT, and only including three aspects, provides only an overall assessment of the construct without capturing the individual ability of each manager to influence firm performance. Future researches can proceed this subject through describing the construct of management at more multiple levels and more meaningful aspects. Third, the dimensions of firm performance in this study are defined only by financial indicators. While the measurements in some other respects can also be used to represent the performance of MNEs, such as the scale of MNEs, and the size of employment. Therefore, future researches can examine these propositions on more varied dependent variables. Lastly, heterogeneity of TMT is not considered. For example, psychic conflict caused from cultural distance can be heterogeneously realized as for different nationality of TMT. Future study may classify demographic feature of TMT to systematically calculate the interaction effects of TMT on firm performance. In conclusion, with the data of foreign-invested enterprises from various countries operating and listing in China, this study explores the relationship of cultural distance

with MNEs' performance and tested how the interactions of cultural distance with the diversity of a TMT, referring to returnees, high level educated members, and Chinese Communist Party members, relate with MNEs' performance. The findings suggest that an MNE with a larger proportion of returnees, higher level educated members, and members with political connection in the TMT can relatively perform better under the harmful influence made by cultural distance between home- and host-country, especially in the context of China.

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문화거리가 다국적 기업의 성과에 미치는 영향: 최고경영진의 중국 특색 역량을 중심으로

왕설가 · 최성진

요 약

국가 사이의 문화거리가 다국적 기업의 성과에 영향을 미친다는 기존 연구에 기초 하여 본 연구에서는 문화거리로 야기되는 기업의 어려움이 최고경영진의 현지 대응 역량에 의해서 어떻게 완화되는지에 대한 연구 주제에 대해서 탐구하였다. 본 연구에서는 중국 시장에서의 현지 대응 역량은 1) 귀환자 여부 2) 교육 배경 3) 정치적인 연관성과 관련이 있음을 밝혔으며 이를 102개의 다국적 기업 데이터를 활용하여 실증적으로 분석하였다. 즉 이 연구는 다국적 기업 최고 경영진의 해외경험, 교육 수준, 그리고 정부 접근성이 중국이라는 시장에서 문화거리로 야기되는 단점을 상쇄하는 요소라는 사실을 검증하였다. 본 연구는 중국 시장을 넘어 다른 개발도상국에 진출한 외국계 기업의 현지 전략에도 실무적인 함의를 가질 것으로 기대한다.

Key Words: 문화거리, 중국 특색 역량, 귀환자, 교육, 정치 연관