The Effects of Cultural Barriers on Market Entry Strategies
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Abstract: The increasing interests worldwide urge researchers to examine the strategies used specifically for tackling the Chinese market. This urgency is brought forward by the fact of a low success rate of international businesses operating in China in the past twenty years. This paper identifies the fundamental barrier – cultural difference and its impact on Australia-China business practices. It identifies the differences which impinge on basic decision making processes. It raises the issue of where cultural factors should be placed in organizations. It stresses that consideration of cultural differences plays an important role in the success of entering the Chinese market. Through a single case study of an Australian organisation’s operation in China, it is demonstrated that cultural differences should be considered at a strategic level rather than an operational level. This will allow appropriate strategies to be implemented rather than constant adjustments to strategies.

Keywords: FDI, Cross-Cultural Studies, Strategic Management, International Business, Australia, China

Introduction

“We have not been profitable in China over the past about 10 years...but it is necessary for any foreign company to learn about and understand this complex market first before long-term success in this market can be obtained. Vice-president of a Fortune 500 U.S. Firm” (Si and Bruton, 2004)

As the world's fastest growing economy in the past two decades, China has been the major attraction of FDI (Foreign Direct Investment). The net inflows of direct investment have been between US$35 and US$45 billion per year since 1995 (China Review 2005). As an emerging market, China offers the investors a great deal of potential. Its number one attraction is the large number of population as a potential market.

This paper examines the initial stage of investment strategies. It argues that cultural differences have been the major barriers to successful operations. In the past decades, cultural differences were often not considered, even when it was considered, it was often only at the operational level rather than the strategic level. That way, strategies are formulated not suitably for the Chinese market and adjustments are, therefore, constantly required.

China is Australia's 4th largest export destination, 3rd largest import source and 3rd largest trading partner (Dept of Foreign Affairs and Trade Australia, 2004). Australian businesses have been pursuing the Chinese market since the open door policy (White, 1988), similar to many other developed countries. The Australian business pursuit of the Chinese market has not achieved consistently good results. They have ranged from very good profitability meeting projections to no profitability with large capital write-downs. Australian companies which are often small by international standard often cannot sustain the losses.

It is argued in this paper that it has not been recognised widely that the impact of cultural differences is seen by both scholars and practitioners as a major contributor to failure or unsatisfactory performance of organisations (Cartwright and Cooper, 1993; Chung, 2004; Haire, Chung, and Hartel, 2004; Harrigan, 1985; Pothukuchi, Damanpour, Choi, Chen, and Park, 2002; White and Haire, 2003).

Literature review

The right form of FDI methods has long been considered the crucial step to success. Previous research so far has been largely focusing on the driver for FDI and forms of FDI from the investors' point of view. It has been a consistent argument that economic factors are the major driving force for Foreign Direct Investment (FDI) (Ehrman and Hamburg, 1986; Kelly, 1982; Zhang, 2000). These factors may be availability of land, existence and/or costs of raw material, cost and quality of labour, availability and cost of capital, efficiency of production, access to supporting industries, availability and access to technology, closeness to potential or additional market and tax incentives and/or benefits. These factors may be grouped to determine the homogeneity of countries in order to assist the decision making process (Ehrman and Hamburg, 1986; Sethi, 1971; Terpstra and Yu, 1988; Zhang and Zhang, 2001; Zhang, 2000). Other theories such as the "market imperfections paradigm" by Calvet (1981) suggests that the disequilibrium,
which is caused by many factors such as labour, currency, government interference, market structure imperfections, market failure imperfections and etc., are and continue to be the major drivers of FDI. Some research simply refers to FDI as a "strategic necessity" (Zhao and Levary, 2002).

The types of decision criteria used by global (or globalising) enterprises to select overseas investments in business operations are covered across a number of discipline areas in the academic journals, e.g. market entry and JVs (joint ventures) (Beamish, 1999; Bilkey and Tesar, 1977; Brouthers and Brouthers, 1977; Caves, 1971; Delios and Beamish, 1999; Erramilli, 1993; Erramilli and Rao, 1993; Geringer, Beamish, and daCosta, 1989; Loree and Guisinger, 1995) and cultural differences on market entry (Brouthers & Brouthers, 1977).

As for the modes of entry into the literature suggests a sequence of: exporting, international licensing, international franchising, specialised (Mahoney, Trigg, Griffin, and Pustay, 2001) modes and FDI (Mahoney et al., 2001). Breth and White (2002) suggest that companies have been following the following criteria as their decision-making guidelines when entering the Chinese market:

- The amount of capital a company is prepared to commit to the Chinese market; this has previously had a misperception of being at a low level costs.
- The degree of control a company wishes to have over its China operations which plays a crucial role in effectiveness management; and
- The company’s attitude towards risk taking and its assessment of risk in China.

The lack of success urges the investors’ to focus further on their processes of decision making and effectiveness of strategies. Other strategic reasons are also widely considered, i.e. motivation (Si and Bruton, 2004).

Among all the entry modes, JV is one of the most popular forms of entry for companies as it may reduce risk level through less financial commitment. Large amount of research has been undertaken on the question whether JVs are the most appropriate forms of investment in foreign markets since they have been the most popular forms of FDI. It is a strategic variable that firms use to optimise overall approach to international expansion (Beamish, 1988; Beamish, 1999; Beamish and Banks, 1987; Beamish and Karakis, 1999; Erramilli, Agarwal, and Dev, 2002; Guillen, 2003; Li and Tsui, 1999; Li and Tse, 1999; Lin and Germain, 2000). A key aspect has revolved around the relationship between these alternative entry modes and profitability, although, as pointed out by Woodcock, Beamish and Maskino (1998) and Pan, Li and Tse (1999) the empirical studies undertaken thus far have failed to provide consistent findings. Madhok (1997) points out that JVs entail costs associated with searching for an appropriate local partner and integrating the assets pooled by the JV partners. Drawing on Caves and Mehtra’s (1986) claim that total combined costs are often higher for JVs than for wholly owned foreign enterprises.

The area that is lacking is the consideration of the other party, the recipient of the investments. There are no recommendations given to suggest that the investing parties should align their investment decisions with other parties’ objectives especially in a joint venture situation. In this situation, the other party’s objectives are equally important to the success of the corporations. Research thus far rarely looks at the option of JV from both sides of the perspectives of the investor and the foreign partner. The incompatibility of the objectives from both parties plays a critical role to the end results of any JV operations. In this form of FDI, cultural differences which impact directly on firms’ objectives are one of the determinants of that success or failure. The increasing attention paid to the cultural differences indicates the beginning of a new and challenging arena of research in the international business studies especially in the area of market entry strategies into the Chinese market.

The first Chinese FDI law was “The Law of the People’s Republic of China on Chinese-Foreign Joint Ventures” which was adopted by the Second Session of the Fifth National People’s Congress on July 1, 1979 and promulgated on and effective as of July 8, 1979. The forms of foreign capital investments were largely raveled around different forms of joint ventures (Chu, 1986). What is important to observe is the title of the legislation indicated the focus of the government intention of promoting JVs as a primary form of foreign capital injection to the economy. In this form, China not only obtained the capital invest ment but also gained access to Western management skills. It was a typical for Chinese firms, especially the run down ones, to provide the land, existing equipments which were often out of date and the human resources as a part of a JV deal. Foreign investors were typically bringing in investment capital, new technology or equipments and Western management system and philosophy.

China has a distinctly different economic structure. This structure is more complex than the general understanding of the central planned economy. China has its unique structure of a hierarchical order of enterprises and the central planning is highly concentrated at the upper level of the enterprises. The measure of value is based on the gross industrial output value. This has been necessary due to the size and the scale of Chinese enterprises (Wong, 1987).
This is important for investors to understand and consider its impact due to the structure of its distribution system. A major part of any investments relay on the supporting system. The above two areas of distinct differences in the specific Chinese cultural structure determines the effectiveness of strategies.

Culture is important as Pape (1999) points out the trend may not be toward a common global business culture but toward business tribes each sharing an individual culture. This is probably in part due to the difficulty in defining, measuring and quantifying cultural costs. There have been many attempts to put cultural differences into a framework of this nature. One of the major contributors in this area is Hofstede (2001). It has been argued that where the host country is a high context culture (Hall, 1990) and has a less structured legal system investing organisations, particularly is large and inflexible, should try not to pursue non-equity based entry modes (Brouthers, 2002; Lu, 2002). To date approaches to measurement of cultural differences have not been totally satisfactory (Lu, 2002). Therefore the concept of adding cultural differences to potential costs has been a challenge due to the difficulty of uniformed systems of measuring variables to determine the exact cost.

Rapidly, increasing attentions are paid to the importance of cultural difference (Geringer et al., 1989; Geringer and Hebert, 1991; Kelly and Philippatos, 1982; Mitchell, Smith, Seawright, and Morse, 2000; Mitra and Golder, 2002; White and Haire, 2003), still there has not been satisfactory research conclusions on many of the cultural related questions. After a long period of struggle, it is now the beginning of recognition of “cultural differences as the biggest barrier” (Chung, 2004; Pan and Zhang, 2004) in cross-cultural businesses.

**Research method**

A case study approach is used in this research (Yin, 1994). The sample selected was Foster’s Group Ltd, an Australian MNC which made an inroad to the Chinese market. A series of depth interviews were conducted between 2002 and 2005 with executives, board members, senior managers and operational management in both Australia and China. Respondents were current and ex-staff of the organisation. These interviews were conducted on an informal basis with no structured questionnaire. Sackmann (1991) argues that the unstructured interview, by not being based on a set of structured questions beforehand, is the only appropriate form of interview for cultural studies, in order to allow the interviewer flexibility to draw out appropriate and meaningful responses.

Interviewees were invited to respond in as much detail as possible to all questions. Questions focused on a wide range of issues relating to the JVs, including why the market entry form was chosen, how market research was undertaken in China, Foster’s dealings with government organizations, human resources management and marketing practice. In particular, a range of questions were asked with a view to identifying the strategies of Foster’s decision to enter the Chinese market and its suitability to the nature of the market at the time. To further utilise the interviewer’s dual language ability, interviewees were encouraged to speak in the language that they were comfortable with. This leveraged on the benefit of depth description, expression of more accurate cognitive process, therefore, to ensure the quality of the data collected.

**Discussion of the case**

Foster’s initiated its China strategy in the early 90’s. Even though the Constitution of the People’s Republic of China promulgated foreign enterprises and individuals to invest in China (Chu, 1986), at all levels at Foster’s, it was believed that JV was the only permitted solution (O’Hoy, personal communication, 2002; Bett, Norgard, personal communication, 2004; Carter, Williamson, personal communication, 2005) (This was the same case with other international brewers.). The action was driven by the analysis that China would become the largest beer market (Foster’s Brewing, 1993). This was backed by the research report purchased from Hong Kong firms (Holmes, personal communication, 2004). It was predicted that there would not be time to start building manufacturing facilities once the market start to grow. At the same time, other international competitors were rapidly making serious capital investments, the need for establishing in that market was urgent and pressing (Bett, Bullock, Norgard, personal communication, 2004; Carter, personal communication, 2005). Rushed and pressured, Foster’s entered the market with three JVs within the shortest time possible.

All three JVs were established between 1993-1995: one in Shanghai, one in Guangdong and one in Tianjin. Both Shanghai and Guangdong were with Chinese state owned breweries and Tianjin had a third partner—Wheelock—a Hong Kong investment firm. For each of the JV there was a piece of land attached. It was predicted at the time of entry that the capacity would have to be extended soon after the establishment of the JVs (Murphy, personal communication, 2004). This prediction was proven to be inaccurate as none of the land was utilised eventually. Both Tianjin and Guangdong were sold long before such needs rose. Shanghai struggled for
some years to keep the land as it was stipulated by the Chinese government that vacant land could only be held for a certain number of years. SFBL managed to sell the land rather than giving it up (Zhou, personal communication, 2003). Lin and Germain (1999) suggested that the level of investment is another indicator of commitment. Foster’s had no hesitation to demonstrate to their Chinese partners as well as the government their level of commitment. However, was that necessary? “In hindsight, that was perhaps unnecessary.” (Murphy, personal communication, 2004) Little benefit was gained from the exercise.

Seeding exports were carried out on a very small scale to introduce the brand to the market (Carter, personal communication, 2005). Nevertheless, exporting was not an alternative option for Foster’s as beer imports were not encouraged by the Chinese government that import duty would have made the exercise not worthwhile. Further, in reality, import and export was monopolized by China Cereal, Oil and Food Stuff Import and Export Co (CCOFs). Import quotas were issued by CCOFS on a very restricted level (Carter, personal communication, 2005).

When questioned whether JV was the right form of entry, it is argued if Foster’s were to enter the market again, JV could still be selected as the entry mode. This was reasoned on that local partners’ knowledge was the key to smooth establishment in the market (O’Hoy, personal communication, 2002). When entering a market that was extremely foreign culturally, the assistance from a local partner could be tremendously valuable in guiding the company into a new market. However, the incompatibility of objectives was not considered in order to ensure the success of the JVs and the differences of culture acted as a barrier between the Chinese and the Australians within the organisation.

For a joint venture to be successful, it is essential for both parties to have matching objectives. Foster’s had very little idea what their Chinese partners’ objectives were before the signing of the JVs (Murphy, personal communication, 2004; Carter, personal communication, 2005). The differences in cultures did not allow parties to recognise the differences on objectives. The “big brother” approach of Foster’s forbid Foster’s from seeing the cultural differences. It was thought that once the product was produced Chinese consumers would rush to purchase it (Zhang, personal communication, 2004; Yang, personal communication, 2005). The process of establishment in China was a race with other international players.

The different objectives were soon displayed as the research showed that at all three JVs, the Chinese partners played little part in the strategic operations (Bett, personal communication, 2003; Dart, personal communication, 2003; Tee, personal communication, 2004) which appeared to be at odd to the other JVs (Blackman, 1995). Western management often reported that their Chinese partners interfered with the management process and this alone has been a major difficulty (Clissold, 2004) having recognised the lack of interests from the partners. Foster’s soon started to buy additional shares from their Chinese partners. By the end of 2000, Foster’s Shanghai became 100% owned subsidiary of Foster’s. From building a JV point of view, clearly there was no solution being sort after to address the issue of differences in objectives.

Another area which caught Foster’s by surprise was in distribution, (Other foreign firms were in the same boat) which impacted on their success of the market entry. This area was distinctly different because of China’s contemporary culture. The establishment of Chinese government in 1949 dictated a central planning economic structure. Being very experienced in its own distribution system which was set up efficiently in Australia, Foster’s attempted to utilise this knowledge in managing its distribution system in China instead of using the existing system of distribution which was already established for their existing local brands, Foster’s attempted to centralize its distribution to several of the large distributors (Mitchell, personal communication, 2005; Yang, personal communication, 2005). Without consideration of the culture value that was driving the existing structure, the attempt disturbed the equilibrium of the exiting distribution structure. In Hainan Island, the major distributor controlled 10% of the market and Foster’s attempted to implement their own sales and marketing team which clearly was a marketing cannibalism. With great difficulty for the Chinese distributors to understand such behaviour culturally, the relationship with the distributor went to a down turn from there. The culturally regulated behaviour is a core element that has not been addressed in international business operations. Attempts so far are at the superficial level of learning languages and holding chopsticks. This creates a false impression for the expatriates that once they can hold chopsticks they are Chinese or because they do not speak the language they will never be able to communicate with Chinese or understand Chinese. As a result, the production level at Guangdong went down to 30% of its capacity which was a historical low (Mitchell, personal communication, 2005). The sale of Guangdong later was closely related to this result.

Foster’s had extensive knowledge of its Australian market. The distribution was relatively simple compared to the Chinese market. The Australian market was also a well regulated market by ACCC
(Australian Competition and Consumer Commission). In China, such organization did not exist to regulate the market. It was built and relied heavily on the relationships. This deeply imbedded culture in the distribution system was extremely foreign to the Australians. It was described as an "alien" culture by the Australians (Mitchell, personal communication, 2005; Bett, personal communication, 2002). Australian management personnel with nearly zero training and preparation struggled to produce results for the shareholders.

By 1999, following a review of its China strategy, Foster's Tianjin and Foster's Guangdong were consequently being sold. It was agreed by the management of Foster's head office that numerous strategic failures did occur in the process of establishing in the Chinese market. As a result, the opportunity of establishing the brand as a strong international brand in China was not achieved. Although Foster's managed to enter the market at a very early date, the inability of achieving the desired results led Foster's to a major loss of opportunity. The major cause – Cultural difference – was not only eliminated in the above areas demonstrated, but also throughout its operation. This culturally associated cost which is defined as cultural costs was at the value of AUS167.7 million in 1999 (Shield, 1999).

Conclusion

In conclusion, this paper examined the impact of cultural differences on market entry strategies of Foster's China operations. Through case study material it looked at investment decision and distribution channels and how they impinged on the success of market entry. It stresses the importance of cultural differences in international business operation. By identifying the cultural differences prior to setting strategies, organizations are able to design the strategies to suit the particular market. Strategies that are determined in this manner are likely to be suitable for the market environment. Failing the above, organizations found themselves forever in a position to adjust their strategies to suit the market.

References

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About the Author

Dr Mona Chung
Dr Chung has an impressive career conducting cross-cultural businesses internationally. She has depth experience working with organisations establishing operations in China. She specialises in cross-cultural strategic planning, management and marketing practice for international organisations in China. Her major contribution in the area of FDI into China is to identify barriers to successful operations by overcoming cultural difficulties. Her PhD focused on this topic and provided cross-cultural management implications. She is in the forefront of cross discipline research and an author of an extensive list of publications in the area of cross-cultural business studies.