

CULTURAL DIFFERENCES OF COUNTRIES WITHIN A REGIONAL ECONOMIC INTEGRATION AND THEIR IMPACT ON STAKEHOLDERS

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—Abstract —

The objective of this paper is to investigate whether national cultural distances can be calculated within a regional economic integration and how effectively can they be used by stakeholders. The formula to calculate the cultural distance of each country in a regional economic integration is derived from the computations developed by Kogut and Sigh. Hofstede's cultural dimensions values for countries that belong to regional economic integration are used to get the national cultural distances and the average cultural distance of the region. The results were then interpreted in terms of different stakeholders (government, multinational organizations and human resource management). The formula to calculate the nations' cultural distance was derived. The values for every country in the regional economic integration chosen were calculated. Graphical display of the results showed the regions that have similar culture and those with a variety of cultures. The research recommends that governments can use these values to predicate if a regional economic integration can be moved to the next level or not. Multinational organizations can use them for deciding the level of doing business in different countries within the region. Human resource management can use the national cultural distances to come out with suitable strategies for human management within an organization.

Key Words: *Cultural distance, Regional economic integration, Culture, Hofstede cultural dimensions*

JEL Classification: **J1, J4**

1. INTRODUCTION AND BACKGROUND

Regional economic integration enables businesses to find suitable locations/markets for their business ventures across the geographic region. Regional economic integration is defined as agreements among countries in a geographic region to ease, and eventually remove, tariff and nontariff barriers to the free flow of goods, services, and factors of production (Hill, 2014). The workforce have the freedom of working anywhere across the region, making business organizations an environment where diverse workforce meet. The workforce differs in terms of culture, gender, ethnicity, race, etc. This then makes it imperative for human resource management to come out with suitable strategies to manage this diverse workforce (Shena, Chanda, D'Nettob, & Monga, 2009). In this diversity one significant source of conflict in an organization is the culture of different nationalities within the workforce. The conflict emanates from people of different culture interact with one another. Culture is then sometimes seen as a source of disruptive than of synergy (Dartey-Baah, 2013). This then puts culture in the centre of managing global workforce dynamics. The influence of culture increases as the level of regional economic integration increases. The levels of regional economic integration are free trade area, customs union, common market, economic union and political union as the ultimate. The cultural difference within the regional economic integration can be used to be used to predict whether the regional economic integration will grow to the next level and sustainable. Organizations within these regional economic integration need to take cognisance of the fact that if national cultural differences are not managed well they can cause unbearable problems in the organization (MARITZ, 2002). National culture shapes the behaviour of individuals in an organization as well as the organizational culture.

Culture can be defined as a set of shared values, assumptions and beliefs that are learnt through membership in a group (organizations, industries, nations, geographical regions, etc) and that influence the attitudes and behaviours of group members (employees, citizens, etc) (Sun, 2009). It can be assumed that culture is converging but it will take time for that to happen at a regional level as it has happened at the national level. Multinational organizations need to manage national cultural differences of their employees. It is with this in mind that human resource management in a regional economic integration need to have instruments to use in managing this diversity in work place.

2. PROBLEM STATEMENT

Although there are measurements for cultural distance between nations to enable multinational companies to know the cultural distance between host-home countries, there is still problem of knowing a region in term of cultural differences(Colakoglu & Caligiuri, 2008). Politically there is need to know if the regional economic integration will flourish or not due to cultural difference. Multinational companies that are interested in investing in a regional economic integration need to know the cohesion of the region in terms of culture before they invest. Human resource management would want to know the task ahead in their endeavour to harmonize their workforce in a given region given that the multinational business has decided to enter.

3. RESEARCH QUESTION

How cultural differences distances be measured in regional economic integration in order to use them for political, business and social reasons?

In answering the question the following sub-questions will be answered:

How to determine the cultural distance of each country in the regional economic integration?

How to determine the average regional economic integration cultural distance?

How to interpret the cultural distances to stakeholders?

4. RESEARCH OBJECTIVES

The objectives of this research is to:

- derive the formula to calculate the cultural distance of every country in a regional economic integration
- calculate the regions' average cultural distance and each country's cultural distance in the regional economic integration
- analyse the data
- recommend the impact these values have on stakeholders

5. LITERATURE REVIEW

Countries around the world have been coming together to form regional economic integration without having a thought of how this would impact on citizens, businesses and its sustainability. It is also important to envisage whether this

regional integration will grow to the next level or not. Regional Economic Integration (REI) is defined as the commercial policy of discriminatively reducing or eradicating trade barriers only among the states joining together. The lowest level of association involves trade while a deeper integration goes beyond trade (Rahman, Khatri, & Brunner, 2012). Geographical proximity, cultural, historical, and ideological similarities, competitive or complementary economic linkages, and a common language among the Partner States are significantly required for effective economic integration (Mwasha, 2011). Regional economic integration has five (5) levels explained below and examples of regional economic integration in each level are given. The cultural difference is strongly felt within the last three levels of regional economic integration. The following section the levels of economic integration are explained.

- a) Free Trade Area encourages trade among its members by eliminating trade barriers (tariffs, quotas, and other nontariff barriers [NTBs]) among them. The European Free Trade Association (EFTA) and North American Free Trade Agreement (NAFTA) are examples of regional integration in this level. European Free Trade Association (EFTA) comprises of Norway, Iceland, Liechtenstein and Switzerland and then North American Free Trade Agreement (NAFTA) the following countries Canada, Mexico and United States (Estevadeordal, Suominen, & Volpe, 2013)
- b) Custom Union combines the elimination of internal trade barriers among its members with the adoption of common external trade policies toward non-members. Andean Pact (Bolivia, Columbia, Ecuador and Peru) is an example of a customs union (Ajami, Cool, Goddard, & Khambata, 2014).
- c) Common Market eliminating barriers that inhibit the movement of factors of production (labour, capital, and technology) among its members. At this level cultural differences start to have strong influence in the activities of the countries involved and businesses in these countries due to movement of factors of production. Example of regional economic integration at this level is MEROSUR (Brazil, Argentina, Paraguay, and Uruguay) (Raines, 2000).
- d) Economic Union represents full integration of the economics of two or more countries. It also involves free flows of products and factors of production between member countries, and also adoption of common currency, harmonization of member countries tax rates and common monetary and fiscal policy. Example at this level is the European Union

(EU) (Belgium, France, Germany, Italy, Luxembourg and the Netherlands (six founders))(Glanville & Glanville, 2011).

- e) Political Union involves a central political apparatus that coordinates the economic, social and foreign policy of member state(Feldstein, 2000).

EU is headed towards at least partial political union, and United States is an example of even closer political union. EU in this research, the founding members comprising of Belgium, France, Germany, Italy, Luxembourg and the Netherlands (six founders) were analysed (Buckley, Clegg, Forsans, & Reilly, 2001; Hill, 2014).

The influence of culture in nations and regional economic integration have been researched on by many indicating the benefits of taking cultural differences as the centre of managing employees in businesses, organizations and within a regional economic integration(Drogendijka & Slangenb, 2006; Mwash, 2011; Witbooi, Cupido, & Ukpere, 2011). The universality of human resources have been questioned in literature. Culture has a ubiquitous impact on the management of human resources. It influences how employees respond to pay and non-pay incentives, how multinational organizations are organized, the success of multinational team work, and even how executives compose and implement business strategies. Due to the above a number of human resource practices have specific characteristic related to specific country(Dartey-Baah, 2013; Mas'ud, 2009). In the endeavour to find the impact of culture in multinational companies in regional economic integration different cultural frameworks have been used. The mostly used is Hofstede's cultural dimensions. Hofstede defined culture as a set of shared beliefs and values that differentiate people of one nationality from those of another(Dartey-Baah, 2013; Graham, 2009). Hofstede identified four important dimensions in national cultures. The theory is based on the idea that value can be placed upon four cultural dimensions. These are power, individualism, masculinity, uncertainty avoidance. Hofstede gathered most of his data on world cultural values through surveys conducted by International Business Machines (IBM). He then proposed a scoring system using a scale from 1 to 120(Wu, 2006). The four cultural dimensions are discussed below.

Power-Distance index: According to Hofstede (1980), "power distance is the extent to which the less powerful members of organizations and institutions (like the family) accept and expect that power is distributed unequally." This dimension analyzes the way people feel about the level of power distribution in a given culture. High power-distance scores entails that less powerful members of the

society accept their place and realize the existence of formal hierarchical positions. Low power-distance scores entails that a culture expects and accepts that power relations are democratic and members are viewed as equals(Hofstede, 2011).

Individualism index is said to be the degree to which individuals are integrated into groups. Cultures that are individualistic place importance on attaining personal goals. In collectivist societies, the goals of the group and its wellbeing are valued over those of the individual(Hofstede, 2011).

Masculinity: “The distribution of emotional roles between the genders.” This dimension measures the level of importance a culture places on stereotypically masculine values such as assertiveness, ambition, power, and materialism as well as stereotypically feminine values such as an emphasis on human relationships. Cultures that are high on the masculinity scale generally have more prominent differences between genders and tend to be more competitive and ambitious. Those that score low on this dimension have fewer differences between genders and place a higher value on relationship building(Hofstede, 2011).

Uncertainty-Avoidance index: “A society’s tolerance for uncertainty and ambiguity.” This is a dimension that measures the way a society deals with unknown situations, unexpected events, and the stress of change. Cultures that score high on this index are less tolerant of change and tend to minimize the anxiety of the unknown by implementing rigid rules, regulations, and/or laws. Societies that score low on this index are more open to change and have fewer rules and laws and more loose guidelines(Hofstede, 2011).

These Hofstede dimension have been used to find the compatibility of countries in entering a given country to do business. Kogut and Singh's (1988) formula for national cultural distance has been used to find out the suitability of one country in doing business in other country (Morosini, Shane, & Singh, 1998).

Kogut and Siggh’s formula is given as(Kogut & Singh, 1988):

$$CD_{jc} = \frac{1}{4} \left(\sum_{i=1}^4 \frac{(I_{ij} - I_{ic})^2}{V_i} \right) \quad (1)$$

where CD_j is the cultural distance between country j and country c

I_{ij} is country j 's score on the i^{th} cultural dimension

I_{ic} is the other country c 's score on the i^{th} cultural dimension

V_i is the variance of the score of the dimension and is calculated using the formula 2 below:

$$V_i = \frac{1}{(N) \text{ or } (n-1)} \sum_{i=1}^n (x_i - \bar{x})^2 \quad (2)$$

=

where \bar{x} is the sample mean and n is the sample size
 N is the population size.

This formula has been used for comparing two countries at a time. It is not suitable to visualize the compatibility of a regional economic integration in terms of cultural differences.

6. RESEARCH METHODOLOGY

The search methodology pertains to how the information in the research was gathered, analysed and reported. It focuses on the process, the kinds of the tools and procedures used during the research (Witbooi, et al., 2011).

In the endeavour to answer the questions in section one the regional economic integration blocks were chosen. The selection was done depending on that they belonged to different levels of the regional economic integration. The following regions were chosen: European Free Trade Association (EFTA) (Iceland, Liechtenstein, Norway, and Switzerland), North American Free Trade Agreement (NAFTA) (Canada, Mexico, and the United States), Andean Pact (Bolivia, Colombia, Ecuador, and Peru), MEROSUR (Argentina, Brazil, Paraguay, Uruguay and Venezuela) and European Union (EU) (Belgium, France, Germany, Italy, Luxembourg and Netherlands). For EU only the founding countries were used.

To calculate the cultural distances of the countries in these regional economic integration, we rely on the cultural framework of Hofstede (2001). Hofstede's culture scores for different countries can be found on the following website <http://geert-hofstede.com/> that is the ones used in this research. Each of the countries is given a score on four cultural dimensions, Power Distance; Individualism; Masculinity and Uncertainty Avoidance.

The measure of cultural distance was derived from the computations developed by Kogut and Sing (1988), based on Hofstede's dimensions(Yener, 2012). The formula derived thus reads:

$$CD_j = \frac{1}{4} \left[\frac{\sum_{i=1}^4 (I_{ij} - I_{iA_i})^2}{V_i} \right] \quad (3)$$

where CD_j is the cultural distance between country j and the average of the score of the dimension,

I_{ij} is the country j 's score on the i^{th} cultural dimension,

I_{iA_i} is the average score of the countries on this dimension,

V_i is the variance of the score of the dimension.

Finally the cultural distance regional economic integration is obtained as follows:

$$CD_{r_i} = \frac{\sum_{j=1}^n CD_j}{n} \quad (4)$$

where CD_{r_i} is the cultural distance of the regional economic integration,

n is the number of countries in the regional economic integration.

After applying the formulas to Hofstede cultural scores of the dimensions, the resultant values are interpreted in terms of how they can be used by politicians, multinationals and human resource management.

7. DATA ANALYSIS/CRITICAL ANALYSIS AND DISCUSSION OF FINDING

Table 1: Calculated values of cultural distance of different countries in a regional economic integration

	Countries	Power Distance	Individualism	Masculinity	Uncertainty Avoidance		CD
EFTA	Norway	31	69	8	50	FTA	0.548033
	Iceland	30	60	10	50		1.20028
	Liechtenstein	34	69	49	58		0.508732
	Switzerland	34	68	70	58		0.742955
	Av	32.25	66.5	34.25	54		0.75
	Sd	2.061552813	4.358898944	30.40148023	4.618802154		0.317176
	Var	4.25	19	924.25	21.33333333		0.100601
NAFTA	Canada	39	80	52	48	FTA	0.476286
	Mexico	81	30	69	82		1.208679
	United States	40	91	62	46		0.315035
	Av	53.33333333	67	61	58.66666667		0.666667
	sd	23.96525262	32.51153641	8.544003745	20.23198787		0.47627
	var	574.3333333	1057	73	409.3333333		0.226834
	Andean Pact	Bolivia	71	12	52		77
Columbia		67	13	64	80	0.270524	
Ecuador		78	8	63	67	1.408792	
Peru		64	16	42	87	1.285849	
Av		70	12.25	55.25	77.75	0.75	
sd		6.055300708	3.304037934	10.37223859	8.30160627	0.698212	
var		36.66666667	10.91666667	107.5833333	68.91666667	0.4875	
MEROSUR	Brazil	69	38	49	76	Common Market	0.7384
	Argentina	49	46	56	86		1.220699
	Paraguay	59	40	47	87		0.00206
	Uruguay	61	36	38	99		1.038841
	Av	59.5	40	47.5	87		0.75
	sd	8.22597512	4.320493799	7.416198487	9.416297928		0.536823
	var	67.66666667	18.66666667	55	88.66666667		0.288178
EU	Belgium	65	75	54	94	Economic Union Political Union	0.843677
	France	68	71	43	86		0.627275
	Germany	35	67	66	65		0.61015
	Italy	50	76	70	75		0.361056
	Luxembourg	40	60	50	70		0.766353
	Netherlands	38	80	14	53		1.79149
	Av	49.33333333	71.5	49.5	73.83333333		0.833333
	sd	14.2501462	7.176350047	20.07735042	14.71620422		0.497589
	var	203.0666667	51.5	403.1	216.5666667		0.247595

Figure 1: Cultural distance of EFTA member countries

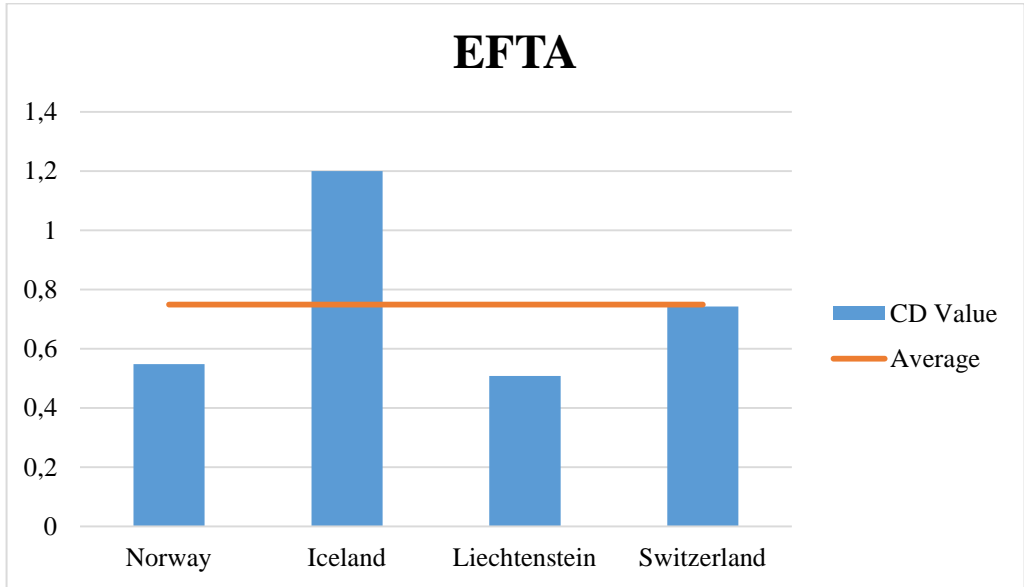


Figure 2: Cultural distance of NAFTA member countries

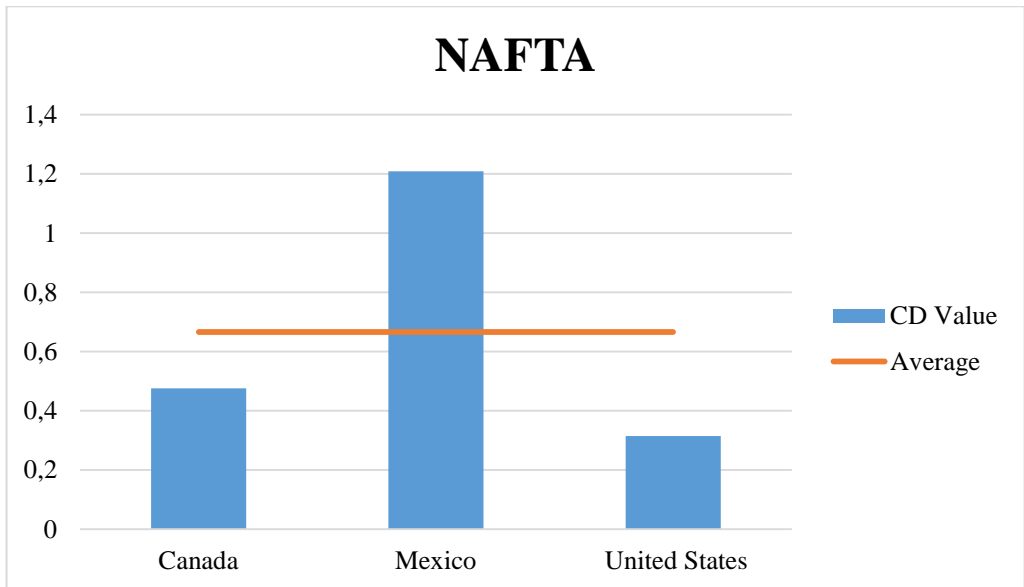


Figure 3: Cultural distance of ANDEAN member countries

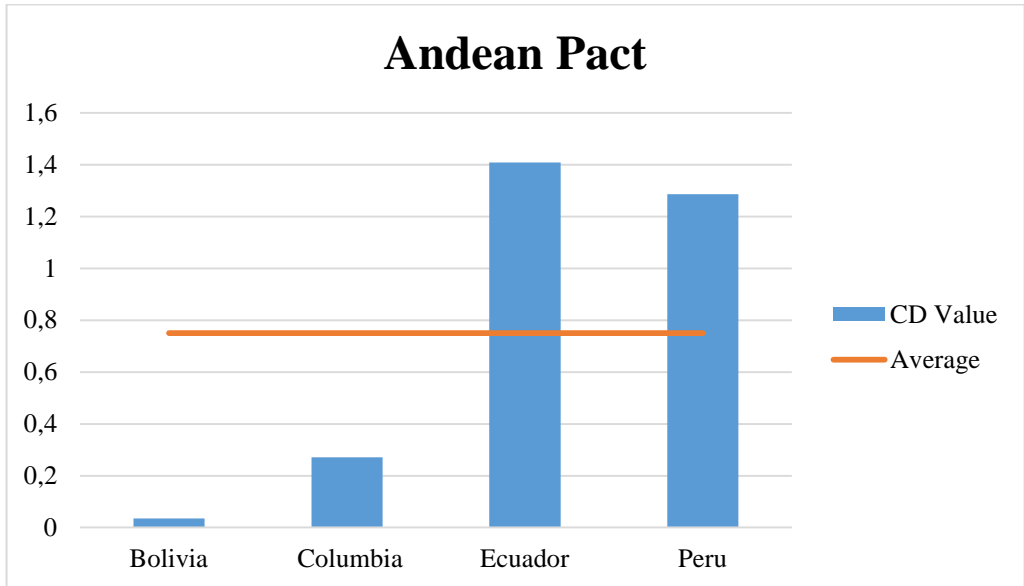


Figure 4: Cultural distance of MEROSUR member countries

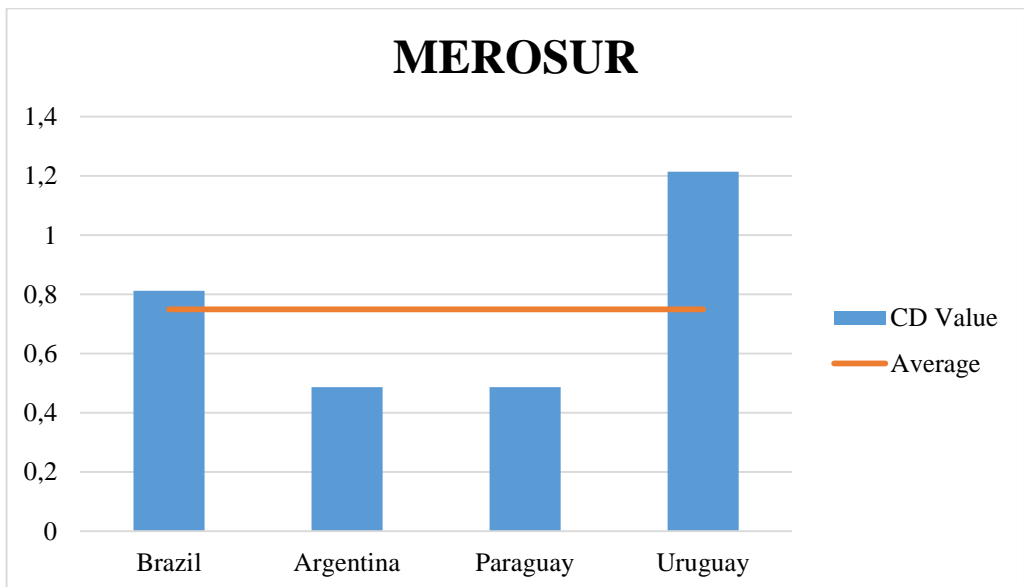
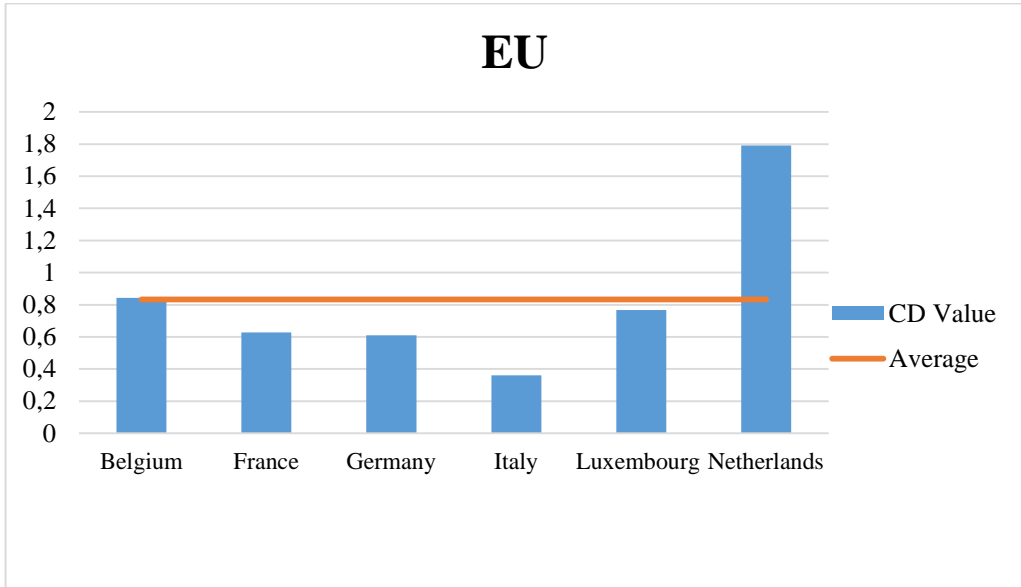


Figure 5: Cultural distance of EU founder member countries



This section explains the graphs above. The visualization of the cultural distance of countries in regional economic integration give instant information to multinational businesses, human resource management and politicians which countries in the regional economic integration are compatible in terms of culture and which are not. In figure 1 (EFTA) it can be observed that Icelanders they need intervention when they are supposed work abroad or receive other nationals within the regional economic integration. Figure 2 (NAFTA) shows that the Americans and Canadian almost have similar culture thus their people will not have much problems in working in either country. The Mexicans will be problems in the region in terms of culture. Figure 3 (ANDREAN Pact) is split in the middle and figure 4 also that is to say half of the countries have similar culture. Figure 5 (EU) shows that Netherland is the odd out. The majority of the countries have almost the same culture enabling movement across the region much easier. This data can be used by all stakeholders to enable their people to converge to almost similar culture in the region. Multination organizations can conform to the culture of the region, this will also help the region converge the required culture.

8. RECOMMENDATIONS AND CONCLUSION

It is recommended that multinationals, governments and human resource management use this instrument of seeing the cultural difference of their region

economic integration to management workforce in the region. They can also use it to find out which nationals need help in order to fit well in the hosting country. Decisions to move a regional economic integration to the next level or not can be taken looking at the region's cultural differences distances. Some regions are suited at the first two levels of regional economic integration and others can move to any of the last three levels. Human resource management must come out with new strategies of dealing with employees on different regional economic integration. We also recommend that further research be undertaken to find out the correlation between cultural distance between nations and the national performance of the economy in a regional economic integration. In conclusion, regional economic integration with so much cultural differences are advised to only operate in levels one and two. The regional economic integration with similar cultures can move to the upper levels.

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