The Role of Social Capital and Cultural Biases in Finance: The Investment Behavior of Foreign High-Tech Firms

James Ang, Yingmei Cheng, and Chaopeng Wu*

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James S. Ang
Department of Finance
College of Business
Florida State University
Tallahassee, FL 32306-1110
Telephone: (850) 644-8208
Fax: (850) 644-4225
E-Mail: jang@cob.fsu.edu

Yingmei Cheng
Department of Finance
College of Business
Florida State University
Tallahassee, FL 32306
Telephone: (850) 644-7869
E-mail: ycheng@cob.fsu.edu

Chaopeng Wu
School of Management
Xiamen University
Xiamen 361005, P. R. China
E-Mail: wuchaopeng@163.com

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Abstract

Investment by foreign firms in a host country is a good setting to study the role of social capital and cultural biases in finance. We investigate investment by foreign high-tech firms in China. We find social capital of provinces in China, social capital of the foreign company’s home country, and the cultural difference between the two countries are important factors in foreign direct investment. Provinces in China with a higher level of social capital attract more foreign investment. Foreign firms in provinces of higher social capital are more likely to establish joint ventures with local partners, conduct more R&D investment, and hire more R&D personnel. We find foreign companies from countries with lower social capital and greater cultural difference from China give even more weight to the provincial-level social capital in China. Our results are robust to alternate measures of social capital, and the conclusions do not change in instrumental variable regressions.