Journal of World Business 51 (2016) 404–412

Contents lists available at ScienceDirect

Journal of World Business

journal homepage: www.elsevier.com/locate/jwb

Reconceptualizing cultural distance: The role of cultural experience reserve in cross-border acquisitions

Manish Popli [a,1], Mohammad Akbar [b,2], Vikas Kumar [c,*], Ajai Gaur [d,3]

[a] Indian Institute of Management, Prabandh Shikhar, Rau Pithampur Road, Indore, MP 453556, India
[b] Indian Institute of Management, Prabandh Nagar, Sitapur, Lucknow, UP 226013, India
[c] Discipline of International Business, University of Sydney, 21-25 Codrington St, Darlington, NSW 2006, Australia
[d] Department of Management and Global Business, Rutgers Business School – Newark and New Brunswick, 1 Washington Park, Newark, NJ 07102, United States

ARTICLE INFO

Article history:
Available online 8 December 2015

Keywords:
Organizational learning
Cross-border M&A
Cultural friction
Cultural experience reserve
Deal abandonment

ABSTRACT

Cultural distance is one of the most widely used distance construct in international business. However, scholars have long questioned the notion that cultural distance has a homogenous impact on organizational actions and performance. We redress this by examining how the relationship between cultural differences and deal abandonment in cross-border acquisitions is contingent on firm-level cultural experience reserve and industry affiliation. Drawing on the organizational learning theory and cultural friction perspective, we first propose that the cultural experience reserve of a focal firm mitigates the positive impact of cultural differences on cross-border deal abandonment. We then hypothesize that the firm's industry context affects the uncertainties associated with cultural differences. Our findings based on a sample of 197 Indian services sector firms support our theoretical predictions.

1. Introduction

Cross-border business transactions have long been analysed by international business (IB) scholars through the lens of cultural differences. Most studies operationalize cultural differences through the cultural distance index developed by Kogut and Singh (1988). Despite its importance to study international business decisions, the construct of cultural distance has received a great deal of criticism by several scholars (Gibson, Maznevski, & Kirkman, 2006; Shenkar, 2001; Tung & Verbeke, 2010). Scholars have called to improve the precision of models examining the impact of cultural distance by including firm level and contextual contingencies, which hitherto remain less explored (Gibson et al., 2006; Zaheer, Schomaker, & Nachum, 2012). To that end, we introduce cultural experience reserve as an important firm level capability that conditions the effect of cultural differences on firms' strategic decisions. We utilize the setting of cross-border deal abandonment (Dikova, Sahib, & van Witteloostuijn, 2009) to demonstrate that the impact of cultural distance is not homogenous, but contingent upon a firm's cultural experience reserve and its industry affiliation.

We propose that experience gained through prior cross-border merger and acquisition (M&A) deals and post-M&A integration in culturally similar countries (i.e. in a same cultural cluster) generate a cultural experience reserve for the focal firm (Luo & Shenkar, 2011). As firms globalize in terms of scale and scope of geographic markets, the extent of cultural differences they face are likely to be different from what we measure based on cultural distance scores between the home and host countries (Luo & Shenkar, 2011; Tung & Verbeke, 2010). While recognition of dynamism in cultural distance and the role of contextual factors has received some attention (Leung, Bhagat, Buchan, Erez, & Gibson, 2005; Shenkar, 2001, 2012), attempts to incorporate such dynamic aspects in empirical studies are in a preliminary stage (Hutzschenreuter & Voll, 2008; Hutzschenreuter, Voll, & Verbeke, 2011).

Organizational learning theory suggests that prior cultural experience manifests in organizational knowledge, both in the sense of stock and process, and hence, it should manifest in a reduced impact of cultural differences (Orlikowski, 2002). However, there has been little scholarly effort to operationalize and examine the impact of foreign experience of firms as an instrument

* Corresponding author. Tel.: +61 2 9351 6438.
E-mail addresses: manishp@iimidr.ac.in (M. Popli), ma@iiml.ac.in (M. Akbar), vikas.kumar@sydney.edu.au (V. Kumar), ajai@business.rutgers.edu (A. Gaur).
[1] Tel.: +91 731 2439542.
[2] Tel.: +91 9811390592.
[3] Tel: +1 732 646 5094; fax: +1 973 353 1664.

http://dx.doi.org/10.1016/j.jwb.2015.11.003
1090-9516/

to close cultural gaps (Shenkar, 2001, 2012). More specifically, the extant literature has not considered the degree of similarity in gaining cultural experience as well as the time between different events through which firms gain cultural experience (Tung, Worm, & Fang, 2008). We develop a dynamic measure of cultural experience reserve for each focal firm based on the quantum of prior, similar experiences of the focal firm and the duration of such cultural experiences. We conceptualize cultural experience reserve of a firm as an idiosyncratic, firm-specific capability that could help to reduce uncertainity in deal negotiations, resolve deadlocks and reduce the risk of deal abandonment in subsequent deals for the focal firm (Very, Lubatkin, Calori, & Veiga, 1997).

Further, we suggest that the impact of cultural differences is contingent on firm specific and contextual factors (Gibson et al., 2006; Lee, Shenkar, & Li, 2008; Zaheer et al., 2012). A recent study by Slangen and Beugelsdijk (2010) shows that the negative effect of cultural distance is more prominent in a firm's cross-border vertical activities than in its horizontal activities. Similarly, Zaheer et al. (2012, p. 24) note that "[i]n some cases firm-level characteristics might mitigate or exacerbate the effects of distance". Cultural uncertainty, unlike other exogenous uncertainties, such as economic and institutional uncertainties, is endogenous to the firm and depends upon the context and the type of firms involved in the cross-border transaction (Cuypers & Martin, 2010). Advancing the role of contingent factors, we propose that the relationship between cultural distance and likelihood of cross-border M&A deal abandonment is also contingent on the industry context.

We test our hypotheses using data on cross-border M&A deals by 197 Indian service sector firms between 2001 and 2010. Our findings suggest that the relationship between cultural distance and the likelihood of cross-border deal abandonment is positively moderated by cultural experience reserve of the focal firm. Furthermore, this relationship is stronger for knowledge-intensive firms than capital-intensive firms. In the next section, we discuss the limitations of cultural distance construct and the recent scholary attempts to address them. This is followed by an overview of the literature related to the impact of cultural distance on cross-border M&A deal abandonment. Next, we develop the hypotheses regarding the moderating impact of cultural experience reserve and firm's industry affiliation on the relationship between cultural distance and cross-border deal abandonment. We then describe the methodology, report the empirical results and discuss the contributions of our findings.

2. Theory and hypotheses

2.1. Cultural distance: limitations and the implications for the research

Understanding the host country culture is critical for success of international business operations. In the broad contours of institutional perspective, scholars consider culture as part of the informal institutions (Scott, 1995). Without undermining the importance of formal institutions (Gaur & Lu, 2007), the focus of this paper is in understanding the role played by informal institutions, i.e. culture and cultural distance in deal abandonment decisions.

The operationalization of cultural distance through Kogut and Singh (1988) index has received much criticism lately (Sarala & Vaara, 2010; Shenkar, 2012; Tung & Verbeke, 2010). Many studies on the effect of cultural distance on different organizational outcomes report inconclusive results (Brouthers & Brouthers, 2001; Kirkman, Lowe, & Gibson, 2006; Stahl & Voigt, 2008; Tihanyi, Griffith, & Russell, 2005). These inconclusive findings have led scholars to raise conceptual and methodological limitations in the cultural distance construct (Drogendijk & Slangen, 2006; Shenkar, 2001; Zaheer et al., 2012). For example, referring to the simplistic view of culture in organizational studies, Leung et al. (2005, p. 374) note that, "A major challenge for the field is to develop mid-range, dynamic frameworks of culture that are sensitive to nuances in different contexts".

Several authors have responded to the call for richer conceptualizations in the use of cultural distance construct (Drogendijk & Zander, 2010; Gaur, Delios, & Singh, 2007). For example, examining headquarter-subsidiary relationships in the European context, Drogendijk and Holm (2012) question the assumption of symmetry implicit in studies utilizing cultural distance to predict organizational outcomes such as subsidiary competence development. They emphasize that although the cultural distance scores might be similar between two corporate actors (headquarters and subsidiary), it is difficult to draw conclusions about organizational implications without incorporating the actual positions of the actors on a cultural dimension. In other words, rather than the difference between host and home country cultural scores, what matters is the actual positions of the two countries on cultural dimensions. Similarly, in a qualitative study of managerial experience, Chapman, Clegg, and Buckley (2008) argue that objective measures of cultural distance must include the perception of managers considering the historical interaction and events, and political ties between the host and home countries. We build on these prior studies that challenge the notion of assumed symmetry by developing the concept of 'cultural experience reserve', a firm level contingency that enables a more nuanced understanding of the effect of cultural distance. Incorporating firm-specific capabilities and contextual factors into the analysis may help in overcoming the systematic overestimation of cultural distance's influence on firm level outcomes (Harzing, 2003; Popli & Kumar, 2015).

2.2. Cross-border M&A negotiations and the impact of cultural distance

A typical M&A process involves three main stages: pre-announcement (first phase), announcement through resolution (second phase), and post-M&A integration (third phase) (Boone & Mulherin, 2007). In a cross-border setting, the second phase involves negotiations, which may create complexities due to uncertainties triggered by various constraints. Negotiations involve the acquirer and target firms' managers and promoters, and often cover contentious issues of valuation, pricing, deal structure, degree of structural integration, as well as its process, amongst others. Despite the involvement of sophisticated institutional intermediaries such as investment banks, cross-border deals remain complex due to cultural differences, and misunderstandings that can easily arise due to unconscious cultural blindness, a lack of cultural knowledge, projection of similarities or parochialism.

Cultural differences between acquiring and target firms create problems for understanding non-verbal cues (Dikova et al., 2009; Gaur, Malhotra, & Zhu, 2015; Malhotra & Gaur, 2014). Culture affects individual perception and behaviour, as well as firm-level processes, such as management styles, decision making and conflict resolution (Kirkman et al., 2006). In turn, cultural differences can lead to greater difficulties during the negotiation process and result in conflict (Tse, Francis, & Wall, 1994). Many cross-border deals fail because of one party's inability to accept or adapt to the underlying beliefs of the other party (Malhotra & Gaur, 2014). Cultural differences also blur information exchanges, which are critical for valuation and post-deal integration. Trust deficits are manifestations of national-level cultural differences and can be potential deal breakers in cross-border M&A negotiations (Dikova et al., 2009; Very & Schweiger, 2001). However, firms differ. The