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Foreign bank subsidiaries' risk-taking behavior: Impact of home and host country national culture

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A B S T R A C T

This paper examines whether the risk-taking behavior of foreign affiliates of multinational banks is more influenced by the national culture of their parent banks' home country or the national culture of foreign affiliates' host country. The study uses a dataset of 292 foreign affiliates (i.e., subsidiaries or branch operations) operating in 66 countries having parent banks in 26 countries for empirical analysis. National culture of both home and host countries is measured with four dimensions—uncertainty avoidance, individualism, masculinity and power distance—of Hofstede's framework of national culture. Findings suggest that the national culture of parent banks' home country has higher impact on the risk-taking behavior of foreign affiliates of multinational banks than the national culture of their host country. Specifically, foreign affiliates' risk-taking is higher if parent banks' home country has low uncertainty avoidance, high individualism and low power distance cultural values. This study extends our understanding that how informal institutions, such as the national culture, influence the financial decisions in multinational banks.

1. Introduction

The global financial crisis (GFC) of 2008 has motivated new research on risk-taking behavior of multinational banks. Recent studies such as Gulamhussen et al. (2014) and Berger et al. (2016) find that more internationalization increases risk of multinational banks and support the market risk hypothesis—whereby internationalization increases bank risk-taking due to market-specific factors in foreign markets—over the diversification hypothesis—whereby internationalization allows banks to reduce risk through diversification of their operations. If internationalization increases risk of a multinational bank, then we left with the question that "what factors encourage foreign affiliates (i.e., wholly-owned subsidiaries or branch operations in countries other than the parent bank's home country) to take more risk and consequently increase the aggregate risk of the multinational bank?" Recent literature has investigated this question to some extent. These studies have largely considered the impact of differential in home country (i.e., the country of parent multinational bank's head office) and host country (i.e., the country in which affiliate operates) market structure and regulations. For example, recent studies report that strict regulations of home country encourage affiliates of international banks to weaken lending standards in host countries with fewer regulations (Houston et al., 2012; Ongena et al., 2013; Berrospide et al., 2016). This paper goes beyond this literature and examines whether differential in home and host country informal institutions, such as national culture, can impact the risk-taking decisions of foreign affiliates of multinational banks. Specifically, we

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investigate whether the risk-taking behavior of a foreign affiliate of a multinational bank is more influenced by the national culture of its parent bank's home country or by the national culture of its host country.

Culture is generally defined as a set of norms, beliefs, expected behaviors and shared values that serves as guiding principles in people's lives (Schwartz, 1994; Hofstede, 2001). By guiding human behavior, cultural values reflect what a society/group considers to be legitimate or illegitimate, good or bad, acceptable or unacceptable, or ethical or unethical (Hofstede, 2001).

Both the national culture of home country and the national culture of host country might be important for the risk-taking decisions of a foreign affiliate of a multinational bank. For example, the institutional framework of Williamson (2000) suggests that national culture as level-1 informal/social institution conditions all lower level institutions including governance structures and practices of firms operating in a country. Consistent with this view, existing literature argues that prevailing culture of individuals may exert its influence on decision-making and risk-taking of a business being operated by these individuals (Tse et al., 1988; Hilary and Hui, 2009; Graham et al., 2013).

Strategic decisions and standard operating policies for multinational banks are usually devised at head office level and foreign affiliates in different countries then follow and implement head office decisions and policies. As head office decisions are made by home country managers, the effects of cultural values of home country are likely to influence risk-taking decisions of foreign affiliates. However, home country managers also consider host country culture while making these decisions for foreign affiliates. For example, existing literature suggests that the culture of host country is important for financial decisions of multinational firms as it takes time to learn the local market's language, preferences, and informal institutions (Li and Guisinger, 1992; Mian, 2006). On the other hand, generally multinational banks hire affiliate management from host country who carry the cultural values of host country. Since several operating decisions are made by the host country managers at affiliate level, host country culture is also likely to influence affiliate level risk-taking decisions. Thus, both home and host country cultures can influence decisions of affiliates, however which culture is more important is an open question and boils down to empirical investigation.

Recent studies have examined the influence of national culture on bank risk-taking behavior (Kanagaretnam et al., 2014; Ashraf et al., 2016c). However, one concern with both of these studies is that they do not make a distinction between domestic banks and foreign affiliates for examining the impact of national culture on foreign affiliates separately. In addition, since both home and host country cultures might influence foreign affiliates, these studies do not identify and consider cultures of home and host countries separately for foreign affiliates.

To answer our question, we use a sample of 292 foreign affiliates of multinational banks operating in 66 countries having parent banks in 26 countries. We measure national culture of both home and host countries with four dimensions—uncertainty avoidance, individualism vs. collectivism, masculinity vs. femininity and power distance—from Hofstede's framework of national culture. We find robust evidence that risk-taking behavior of a foreign affiliate of a multinational bank is largely determined by the national culture of parent bank's home country rather than the national culture of its host country. Our findings depart from existing literature on bank risk-taking behavior. Existing studies report that national culture influences risk-taking behavior of all banks operating in a country, however we find that national culture of a country has little impact on foreign affiliates (i.e., foreign banks) operating in that country. Contrary it is the national culture of parent bank's home country which has significant influence on risk-taking behavior of foreign affiliates.

Our study contributes to the existing literature in several ways: *First*, we contribute to the literature which examines the determinants of risk-taking behavior of foreign affiliates of multinational banks. Existing studies largely consider market structure and formal institutions such as banking regulations (Houston et al., 2012; Ongena et al., 2013; Berrospide et al., 2016). We extend this literature by considering the impact of informal institutions in the form of national culture. To best of our knowledge, this paper is the first one to study the influence of national culture on the risk-taking behavior of multinational banks. *Second*, we contribute to national culture and finance literature in general, and to national culture and banking literature (Kanagaretnam et al., 2011, 2014; Zheng et al., 2013; Zheng and Ashraf, 2014; Ashraf et al., 2016c) in particular. We extend this literature by identifying the national culture's significance for risk-taking behavior of foreign affiliates of multinational banks. *Third*, our study also complements to the recently expanding literature which argues the importance of institutional factors for bank practices. In this direction, recent studies have found that country-level legal institutions (Houston et al., 2010; Fang et al., 2014; Ashraf and Zheng, 2015), political institutions (Ashraf, 2016, 2017), trade and capital openness (Ashraf, 2015) and national culture (Kanagaretnam et al., 2011, 2014; Ashraf et al., 2016c) have significant influence on bank dividend payments, risk-taking and earnings management practices. We add to this literature by considering the impact of national culture on risk-taking behavior of foreign affiliates of multinational banks.

Rest of the paper proceeds as follows: Section 2 defines national cultural framework used in this study. Section 3 summarizes recent related literature. Section 4 explains the expected impact of four dimensions of national culture on bank risk-taking behavior. Section 5 describes data. Section 6 introduces methodology and variables. Section 7 reports empirical results. Final section concludes the study.

2. Measurement of national culture

We use national cultural framework of Hofstede (1980, 2001) and Hofstede et al. (2010) to measure national culture. Hofstede (1980) defines national culture as the collective mental programming that distinguishes the individuals of a nation from the individuals of other nations. Hofstede (1980) measures national culture with four dimensions; uncertainty avoidance (UA), individualism/collectivism (IND), masculinity/feminisim (MAS), power distance (PD). Hofstede (2001) adds fifth dimension named as long-term orientation/short-term orientation (LTO). Hofstede et al. (2010) update fifth long-term orientation dimension and add a sixth dimension, indulgence/constraint (INDULG), by using the data from world value surveys. Each country has a score on a sclae

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