The Effects of Cultural Difference on Cross-border M&A Integration

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Abstract

The article analyzes the effects of cultural difference on cross-border M&A from three facets: the trust between acquirer and target, the human resource integration speed and the efficiency of knowledge transfer between acquirer and target. The conclusion is as following: cultural differences hamper the trust building and increase the resignation rate post-M&A; in the aspect of knowledge transfer, people in individualist culture prefer written and codified information, while people in collectivist culture prefer tacit information. To alleviate the cultural conflict in the process of cross-border M&A, culture due diligence and proper integration mode choice should deserve equal attention.

Keywords: Cultural difference, Cross-border acquisitions, Integration

1. Introduction

Mergers and acquisitions have become one of the most popular internationalization and growth strategies, thus significantly shape our international business environment. Although many managers pursue this strategy, 60 percent of M&As failed. U.S. M&A expert Philip H.Mirvis (1992) pointed out in his book “Managing the merger”, that besides the price, purpose and timing, poor management is an important reason for the failure of M&A[1]. While some M&A may be motivated by purely financial reasons, the most related business acquisitions especially cross-border M&A is to improve the competitive position of one or both of the firms by generating “synergies”, whereby in combination the two firms create more value than either could achieve alone. If the main purpose of a cross-border M&A is not for restructuring and cost cutting that arise from overlapping activities, but rather on the potential for synergy creation through transfer of capabilities, resource sharing and learning, the failure rate will be much higher.

King et al (2003) pointed out that, it is biased to assess from the financial indicators, since a great number of M&A motivation is not for finance purpose [2].Therefore, many studies on M&A turn to organizational behavior and human resources integration. A large number of studies now turn to cultural conflict and cross-cultural management. The main themes are cultural distance (Morosini et al. 1998) [3], cultural compatibility (Cartwright and Cooper, 1993) [4], cultural match (Weber et al. 1996) [5], management model similarity (Datta 1991, Larsson and Finkelstein 1999) [6][7], cultural change (Birkinshaw et al.2000) [8], cultural convergence (Larsson and Lubatkin 2001) and assimilation (Nahavandi and Malekzadeh 1988) [9][10].

The premise of these studies is the cultural distance hypothesis proposed by Hofstede (1991) [11]. Hofstede, the director of Institute for Research on Intercultural Cooperation, suggested the four indicators in describing the culture differences across countries and companies--- individualism & collectivism, power distance, uncertainty avoidance, sexism & feminism. Later, they added long-term orientation & short orientation. Hofstede confirmed the existence of significant culture differences between the different ethnic groups and these differences are rooted in people's minds. Cross-border M&A as an international activities are inevitably influenced by cultural differences.

Although most research in this field confirms that culture affects M&A outcomes and emphasizes its important role in international business, there is growing disagreement among scholars with respect to how culture affect the post-M&A phase. While some scholars argue that cultural differences cause M&As to fail, other studies suggest the opposite.

Instead of studying the simple performance impact of cultural differences in M&A, we should move on to thinking how cultural differences impact on the M&A process and its outcome. The purpose of this paper is to provide insights into why such inconsistencies exist and a more differentiated understanding of culture and integration processes.
2. Literature review

2.1. The negative impact of cultural differences on cross-border M & A performance

Jemison & Sitkin (1986) argued that the great cultural differences between the two enterprises are likely to lead to cultural ambiguity. The greater the cultural distance, the more conflict [12]. The empirical results show that investors often hold negative attitude toward obvious cultural differences between acquisitions. The differences in corporate culture (management style) are likely the main reason for acquisitions not being able to achieve the desired objectives. Some scholars distinguished national culture and corporate culture and asserted that national cultural differences indicate that cross-border M & A performance not being satisfactory. National culture has greater impact because of they are rigid and not easy to be altered. The lack of coordination and measures of conflicts is the main reason for the poor results of operations caused by mergers and acquisitions.

2.2. The positive impact of cultural differences on cross-border M & A performance

Many researches bring a positive attitude toward cross-border M & A. Morosini, Shane and Singh (1998) investigated 52 cross-border M&As between 1987 and 1992, and found that multinational companies can realize performance improvement through entering the target market and getting a variety of practices and skills which are embedded in the national culture [13]. Chakrabarti et al (2009) believed that cultural differences can improve M & A performance, and they are also the sources of synergies [14]. Duncan and Mtar (2006), Zaheer et al (2003) suggested that the recognition and awareness of cultural differences, and some appropriate measures will reduce the conflict of cultural pluralism [15][16]. Gu Weiping (2004) found that national culture and corporate culture differences not only lead to cultural conflict, but also the value of cultural innovation [17].

In summary, scholars did not come to an agreement about the cultural impact on M&A performance. Many scholars such as Schoenberg (2000), Schweiger and Goulet (2000), Teerikangas and Very (2006) and Stahl and Voigt (2008) pointed out that the research findings on that area showed different views [18][19][20][21]. They also suggested it was necessary to carry out further in-depth study.

In order to understand the impact of cultural differences on cross-border M&A, our perspective will turn to the impact on the whole process of M&A. The structure of this article is as following: how cultural differences affect the trust building between acquirer and target, how cultural differences affect the resignation rate, how cultural differences affect the efficiency of knowledge transfer post-merger.

3. How cultural differences affects M & A performance

There are a variety of definitions of organizational culture, but they all contain a basic understanding--- the expectations and assumptions group members shared. Organizational culture is regarded as the personality of the organization and is deeply influenced by the national culture. All the organizations have their own unique culture.

3.1. Trust is difficult to be fostered between acquirer and target

In circumstances of cross-border M&A, it is very difficult to create positive attitudes toward the new organization and the emergence of a sense of shared identity and trust among organizational members. There is extensive evidence in the social psychological literature that people tend to be attracted to those whose attitudes and values are similar to their own [22].

Social identity theory suggests that organizational members show a bias towards members of their own group and tend to hold a negative view about the members of the out-group in order to enhance the relative standing of their own group. In-group bias and “us-versus-them” thinking are likely to be greatest when there is a perceived external threat, such as a takeover attempt, and when the out-group...
is perceived to be very different from the in-group [23]. In such a situation, cohesiveness among the members of the target firm is likely to increase and the takeover attempt may be fiercely resisted. Acquiring managers, on the other hand, may adopt an attitude of superiority and treat the members of the target firm as inferior [24]. In cross-border M&A, feelings of hostility resentment, and distrust may be further fueled by cultural stereotypes and xenophobia [25].

3.2. The impact of cultural differences on the employees’ resignation

Human resources are an important part of the assets in M&A. However, due to the differences in corporate culture and the national cultural, human resources is the most unstable part of the assets. As early as in 1985, Buono’s detailed analysis of a bank acquisitions found that two distinctly different cultures’ merging will make the staff develop the sense of hostility. They defined this malaise “culture shock”. Those who do not want to adapt to the profound culture shock managers may leave the organization. Then many researchers concerned about the impacts of culture shock on employees’ status, psychological reactions and demission. Cartwright and Cooper (1993) stressed that management philosophy and values differences would cause a lot of problems, including senior executives’ demission.

Das and Kumar (2010) concluded that HR integration, especially the changes brought by the two sides on the merger interpretation coupled with language barriers can easily lead to the parties to a conflict [26]. Harrison et al. (2001) and Vaara (2003) pointed out that cultural differences cause employees’ uncertainty and fuzzy feeling [27][28]. When the collective “culture shock” occurs, the acquired will develop a strong resistance behavior (Fink and Holden, 2007) [29].

Mirvis and Marks (2001) also created the word--- “superiority syndrome” to characterize the phenomenon of the acquired status being decreased [30]. The larger the cultural gap is, the more serious impact on the status of the acquired company executives, and the higher resignation rate will be. The structure integration has a negative impact on personnel integration, since it strengthens the cultural differences. Structure integration also results identity and self-government deficiency. Krug and Nigh (1998) proposed that a large number of demission were significantly related with cultural differences, the level of international integration and the acquirer’s performance [31]. Greater differences, higher level of international integration and lower performance resulted higher turnover rate. Larsson and Finkelstein (1999) stressed that, though M&A activity could mean a higher potential value, the cultural differences still might lead executive turnover. Lubatkin (1999), based on the framework of attraction-selection-attrition (ASA), concluded that cultural difference is the direct factor of cultural conflict and acquired managers’ statuses reduction. Moreover, he proposed the hypothesis---the greater differences between two parts, the more executive demission. Through two stages of data collection and analysis, he verified the hypothesis. In summary, the cultural differences and senior executives leaving are positive correlated, and thus have a negative impact on business performance.

3.3. The impact of cultural differences on knowledge transfer post-M&A

Consistent with a value creation perspective on M&A, the focus of this paper is not so much on the possibilities for restructuring and cost cutting that arise from overlapping activities, but rather on the potential for synergy creation through the transfer of capabilities, resource sharing, and learning.

Larsson and Finkelstein (1999) argued that cultural differences may affect the extent to which synergies can be realized by enhancing the “combination potential” of M&A [32]. Synergistic complementarities may include different products, R&D know-how, market access, or managerial synergies from applying complementary competencies. However, combination potential does not automatically translate into synergistic benefits. A growing body of research points to constraints inherent in the process of synergy realization, suggesting that the execution of a well-designed integration process that minimizes interorganizational and intercultural friction is essential to capturing anticipated synergies [33][34].

While other dimensions of cultural variations are relevant for the analysis of cross-border transfer of organizational knowledge, we focus on the role of vertical and horizontal individualism-collectivism in moderating the effectiveness of knowledge transfers. Some countries are clearly more individualistic than other countries in their orientations. Individualism can be defined as a social pattern that consists
of loosely linked individuals who view themselves as independent of collectives and who are motivated by their own preferences, needs, rights, and contracts. Collectivism, however, can be defined as a social pattern that consists of closely linked individuals who see themselves as belonging to one or more collectives (e.g., family, coworkers, ingroups, organizations, tribe) and who are motivated by norms, duties, and obligations, which are imposed by the collectives. People of a given culture emphasize and sample different segments of information from a given body of knowledge; they believe that their ways of thinking about themselves and their groups are obviously correct and do not question their validity.[35]

Individualism and collectivism strongly influence ways of thinking. They influence how members of a culture process, interpret, and make use of a body of information and knowledge. First, there is evidence that in processing information, people in individualist cultures think of the “self” as independent of the immediate social environment and see each piece of information as independent of its context. People in collectivist cultures see the “self” as functioning interdependently with significant others within the immediate social environment and look for contextual cues in each piece of information.[36]

Second, when the knowledge concerns information about organizational history, patterns of obligations, norms, or ingroups and outgroups, people in collectivist cultures are likely to pay attention to it. In contrast, people in individualist cultures are more likely to focus on knowledge when it concerns personal attributes, such as personality, beliefs, feelings, and attitudes toward an event, object, or person. Compared to collectivists, individualists are more concerned with rationality when they transfer and receive knowledge.[37]

Third, in making sense of events, collectivists emphasize historical and contextual information and knowledge to a greater extent than individualists. People in collectivist cultures are less likely than individualists to emphasize the significance of information that is written and codified and are more likely than individualists to disregard such information. In contrast, people in individualist societies pay closer attention to personal goals over collective goals and emphasize rational analyses over historical and contextual information. Individualists look for information in its acontextual form, and they emphasize the significance of information in written and codified form and are more likely to accept such information.

Fourth, people in vertical cultures consider their “self” to be different from others in social status, whereas in horizontal cultures people consider their “self” to be more or less the same as others.[37] In vertical cultures the processing of information and knowledge takes place according to hierarchical arrangements within the organization, with superiors having first access to important pieces of information and knowledge derived from external sources. Superiors may also have the power to decide when and how such information and knowledge are diffused. It is important to note that, in conducting these organizational actions, the superior may not necessarily have the right technical abilities to make these decisions. However, the fact that he or she is in a higher position in an organization located in a society characterized by verticalness enables him or her to have such rights and privileges.

In other words, when the dimension of horizontalness-verticalness is superimposed upon the more fundamental dimension of individualism-collectivism, one gets a better sense of how information and knowledge may be selectively transferred and processed by members of societies that differ along these dimensions.

Vertical and horizontal dimensions are needed when explaining cross-border knowledge transfer, because communication flows differently when the society is vertical than when it is horizontal. Furthermore, in collectivism, one communicates only with ingroup members, and these may be very few within the organization. In individualism, one communicates with anyone in the organization. Therefore, communication presumably would be most widespread within horizontal collectivist cultures.

People in individualist cultures emphasize explicit knowledge, whereas those in collectivist cultures emphasize tacit information and knowledge. People in individualist cultures prefer knowledge independent of its context, whereas those in collectivist cultures prefer systemic or contextually relevant knowledge.
4. How to alleviate the culture effects in the process of M&A

Although culture differences affect M&A performance deeply, we cannot control this risk just after the M&A. At the beginning phase of M&A, the acquirer should conduct careful due diligence, especially for culture.

4.1. Cultural due diligence

The culture requires extensive due diligence analyze national culture, corporate culture, strategy and other business aspects. Those factors will affect the value of the business after the merger. Inadequate due diligence and risk estimates will bring great losses in acquisitions (Zhao Shuming and Zhang Jie, 2005) [36]. As shown in Figure 1, Cultural due diligence is very complex, about 50 to 60% of the time should be used in the due diligence in the M&A process.

![Cultural Due Diligence Flowchart](image)

4.2. Form the new organizational vision as soon as possible

In post-merger integration phase, the fundamental reason for being fail to accept M&A, building mutual-understanding is unable to effectively reach common future expectations. Common organizational vision helps to reduce cultural conflicts, so that each employee can put their thinking and behavior in conjunction with the company's operations and purpose. That will increase the culture integration capabilities in the post-merger phase.

4.3. Establish cultural integration team

When the M&A decision are made, the integration group should be established as soon as possible to explore the procedures and methods of cultural integration. Cultural change means a change in behavior. Cultural integration team members should have the following qualities: no national bias, being ease in multicultural context, expertise in communication, understanding the complexity of human relationships, being culturally sensitive, experience can be used in different countries and regions, quickly adapting to the culture.

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4.4. Select appropriate cultural integration model

According to the level of cultural integration, there are four cultural integration modes---integration, assimilation, separation and de-culturation. From the acquirer’s side, the choice of modes depends on the perceived cultural conflict and cultural differences. For the acquirer’s side, the choice of modes depends on whether they are willing to retain their own culture, and the opinion of the acquirer’s culture. If two parties of M & A tend to choose a more consistent cultural integration mode, the cultural integration process will be smoother. If the two sides’ opinions are divided, it may have negative impact on the combined performance.

The adverse results of overseas financial M&A in Japan, on the one hand, impacted by the economic bubble burst and the financial crisis; on the other hand, by the failure of cultural integration (Zhong Gengshen and Xu Ning, 2007) [37]. When conducted acquisition of the local banks, foreign employees held a lot of information, knowledge, experience and customer relationships, which are the real value. Japanese bank, in face of the overseas institutions, followed the domestic management mechanisms, and did not attach importance localized management. Japanese financial institutions had not placed enough emphasis on the knowledgeable, capable employees, resulting in the loss of experienced local management. The overseas institutional management was Japanese or Japanese-Americans. While other local staff often considered themselves as outsider. Hence their enthusiasm was not high, and their sense of belonging was also poor. Expatriate employees did not establish an effective information exchange mechanism, resulting the local colleagues not willing to give guidance to Japanese employees.

In 1989, Sony acquired Columbia Pictures USA by $3.4 billion in cash, hitting the No.1 case in Japan. Nowadays, this acquisition evaluated by experts as simple and sloppy. After the acquisition, a few Colombia executives left. Meanwhile, Sony’s "global" strategy asks for new American management. But that strategy make the Japanese headquarters stay out of the operating and unable to make decision. For the first five years after the acquisition, Sony's losses had reached $ 2.7 billion. Sony guaranteed at the very beginning that the company would be operated as an American company. As a result, American management, who earned the salary of American level, refused to act the local performance appraisal system. Sony U.S. management team cleverly used the deterrence from the media, and let Sony suffered terribly. In face of enormous cultural conflicts, it was unwise for Sony to empower the American team to solve everything.

4.5. Cross-cultural training

Many foreign multinationals generally believe that Chinese managers have strong analytical skills, they can accept and master new technologies quickly, but barely understand the way of operation (Yan Shimei, 2011) [38]. Therefore, Gallup set problem-solving, leadership skills, interpersonal communication, creative thinking, and negotiation skills as the most in need skills of Chinese managers. At the same time, the mutual understanding and trust of national culture and corporate culture promote the new corporate culture integration. The main content of cross-cultural training includes cultural awareness, cultural sensitivity training, language learning, cross-cultural communication and conflict management. Lucent, for example, developed in-house and low-cost training program. The creative training was designed to address the issues of cultural diversity and significant operating. The courses include: video about the country situation, half a day's business culture to all relevant staff, company's internal Web site, national cultural and practical travel information.

5. Conclusion

Cultural differences are the biggest problems that enterprises face in the process of internationalization. For the enterprises which are or will carry out cross-border M&A, they should establish a shared vision of culture through ongoing training, deal with the executives’ leaving, be ready to adapt to future changes. Talent retention and cultural integration will
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determine the ultimate success of the M & A project. How to solve the cross-cultural problems deserves the long-term attention and study.

In the management of cross-border M & A, capital and skills have tactics impacts; cultural awareness has strategic impact. Existing researches on whether the cross-cultural differences have negatively or positive effect on M & A performance varies. We come to the following conclusions from the three aspects--- the formation of trust, employees’ resignation rate, and knowledge transfer.

1) Since it is not easy to build trust among people of different cultural backgrounds, the formation of a new shared vision will be difficult. Consequently, the failure of establishing shared vision will have negative impact on performance;
2) Due to the difference between high/low context cultures, the cross-border communication is a big obstacle. Consequently, employees’ resignation rate increase.
3) In individualist culture, the written and codified knowledge is easily transferred; in collectivist culture, the tacit knowledge is easily transferred.

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7. References

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