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

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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.

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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
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 uncertainty 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 transactions (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 scholarly 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 headquarters-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
impact of cultural differences is not likely to be similar for all firms carrying out cross-border M&A deals. We elaborate on this in the next section and develop our theoretical arguments based upon organizational learning theory and cultural friction perspective.

2.3. Organizational Learning

Organizations derive several benefits from their cumulative experiences (Argote, 1999; Levitt & March, 1988). Organizational knowledge, derived from experiential learning, can be stored in individual memories and organizational routines (Coyett & March, 1963; Levitt & March, 1988). When organizations face similar situations, this knowledge can be retrieved and utilized to deal with the uncertainties associated with the new decision situation (Perkins, 2014; Shenkar & Zeira, 1992). Firms earn benefits from experiential learning, which is derived from knowledge acquired in previous similar investments (Berry, 2006). A rich body of M&A literature also explicates that prior experience helps firms learn and overcome post-integration issues, increasing their odds of success in subsequent and similar international initiatives (Barkema, Bell, & Pennings, 1996; Barkema & Vermeulen, 1998; Haleblian & Finkelstein, 1999).

Prior experience from foreign markets can build organizational learning in objective knowledge, which includes routines, such as technology transfer, product portfolio management, property, and plant or equipment planning (Delios & Beamish, 2001; Perkins, 2014). This knowledge is similar to other intangible firm assets, such as technological know-how and marketing intensity (Morck & Yeung, 1991). Such knowledge derived from prior cultural overlaps can be a firm-specific capability. Therefore, we posit that cumulative experience in a country, culturally similar to the host country would allow firms to outperform those with no such experience.

Scholars have argued that in contrast to formal institutional imperfections, cultural differences are endogenous hazards that can be mitigated by the focal firm (Cuyper & Martin, 2010; Slangen & Beugelsdijk, 2010; Zaheer et al., 2012). Barkema et al. (1996) empirically analysed the survival rates and longevity of thirteen Dutch firms’ foreign subsidiaries and found that longevity of foreign ventures is associated with cultural learnings of the host country, which in turn depends upon firm experience in the same, or a similar country in the same cultural bloc. In a study of Western expatriates in Hong Kong, Selmer (2006) found that only Asiatic cultural experience was relevant. Additionally, Barkema and Drogendijk (2007) found that the exploitation of cultural knowledge of a particular cultural cluster results in improved, subsequent firm performance. In line with these studies, we conceptualize cultural experience reserve as a firm specific capability based on the prior cumulative experience of the focal firm in any country that is in the same cultural cluster.4 We elaborate on this conceptualization of cultural experience reserve in the following section.

2.4. Cross-border M&A, cultural friction, and ‘cultural experience reserve’

Cultural friction, resulting due to interaction between two entities, is a function of organizational and contextual factors (Luo & Shenkar, 2011; Shenkar, Luo, & Yeheskeli, 2008). The connotation of friction implies a paradigmatic shift from abstract differences to a degree of contact between two entities. Several recent studies have discussed cultural friction based on the magnitude of interaction between two parties. For example, in a study of 23 global projects, Orr and Scott (2008) illustrate the process of friction by which two entities interacted. While Orr and Scott’s (2008) study focused on institutional differences, the process of interaction is equally valid in the context of cultural differences (Shenkar, 2012). The cultural friction perspective suggests that previous cross-border M&A activities provide greater opportunities for managers to interact with new members compared with green-field investments or international joint ventures (Shenkar, 2012). There is also a greater degree of overlap between different cultures, and progressively higher cultural accommodation and learning, in the case of M&A deals as compared to green-field investments.

Experiential learning from prior engagements may help reduce the cultural friction. Research on organizational learning has mapped the learning from individuals to groups, and to organizational levels (Barkema & Drogendijk, 2007; Haleblian & Finkelstein, 1999; Zollo & Reuer (2010) note that management of acquisitions imparts knowledge to individual managers and teams across the organizations, however routines and processes are most likely to be developed at the corporate level and are usable in future corporate development activities. Indeed, firms often deploy senior management executives with knowledge of the host country culture to address cultural sensitivity issues in corporate initiatives (Boyacigiller, 1990; Selmer, 2006). To assuage conflict in a cultural encounter, such as in cross-border M&A deals negotiations, firms deploy experienced expatriates who have a priori cultural knowledge of the host country (Hébert, Very, & Beamish, 2005).

Accordingly, we submit that the pool of knowledge which firms’ managers and expatriates develop results in cultural experience reserve. It diffuses back to the parent firm as a fungible, firm-specific capability, and acts as a mechanism for reducing the impact of cultural differences.

Prior work on the relationship between acquisition experience and performance has produced mixed results (Barkema et al., 1996; Haleblian & Finkelstein, 1999; Hayward, 2002). The mixed findings point towards contingent factors that condition the relationship between acquisition experience and performance (Barkema & Schijven, 2008; Ellis, Reus, Lamont, & Ranft, 2011). For example, Buckley, Elia, and Kafouros (2014) note that structural similarities based upon contextual properties are mapped to unique learning experiences, and influence outcomes in similar M&A contexts. In a similar vein, Chao and Kumar (2010) suggest that for a firm entering in a new location, absolute value of distance (institutional or cultural: between host and home countries), should be less of a concern compared to the ‘marginal distance’ which it has to endure. ‘Marginal distance’ takes into account the learnings of the firm in its prior international pursuits, which an absolute distance score between two countries does not. By integrating organizational learning theory and cultural friction perspective, we argue that a firm’s cultural experience reserve is a function of the number of prior investments in the same context (i.e. same country or a country with similar culture), as well as the size of the investment and the time elapsed (Luo & Shenkar, 2011; Shenkar et al., 2008). We elaborate on the importance of cultural experience reserve using the illustration shown in Table 1.

Assume that there are two firms (1 and 2) that have completed acquisitions in various international cultural blocs (A, B, and C) at different times. Each firm attempts to acquire a firm in cluster C at t*. According to the law of averages (Hutzschenreuter & Voll, 2008; Hutzschenreuter et al., 2011), Firm 1 and Firm 2 should experience similar cultural experience at the end of t*. However, the cumulative cultural experience reserve of Firm 1 as it attempts

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to acquire a firm in cultural bloc C (i.e., C2 at time t2) differs from that of Firm 2, since Firm 2 has spent more time in cultural bloc C (assuming both firms had a similar level of cultural friction in their prior investments in cultural bloc C). That is, even though both firms have the same average cultural experience, the impact of cultural difference that Firm 2 faces, with respect to host country C2, is less than that of Firm 1. In other words, an Indian firm entering into an M&A deal in Korea effectively faces reduced impact of cultural differences if it has prior experience with M&As deals in Korea, Taiwan or another Confucian Asiatic country. Attesting the same, an annual report of an Indian IT company, Agnite Education (erstwhile Teledata informatics), which has made multiple acquisitions, reads as follows:

“Every acquisition is fraught with the threat of cultural change, resistance to business practices etc. But with the experience gained in the last two years, the hurdles in the process are well gauged frontend and duly addressed” (Agnite Education, Annual report, 2006, pp. 38).

In summary, we argue that firms with cultural experience reserve are more likely to mitigate the negative impact of cultural differences, which reduces the probability of a cross-border M&A deal getting abandoned. Accordingly, we hypothesize:

**Hypothesis 1.** The cultural experience reserve of a firm moderates the relationship between cultural distance and the likelihood of cross-border deal abandonment such that the effect of cultural distance is reduced for firms with greater cultural experience reserve.

### 2.5. Firm industry affiliation

In addition to firm level capabilities, industry variations might also affect the relationship between cultural differences and firm level outcomes (Gibson et al., 2006; Tung & Verbeke, 2010; Zaheer et al., 2012). Accordingly, we argue that industry affiliation is an important contextual factor that conditions the effect of cultural distance on cross-border deal abandonment. An important classification for service sector firms is based on the knowledge and capital intensive nature of the service activities (Contractor, Kundu, & Hsu, 2003; Merchant & Gaur, 2008).

There are fundamental differences between knowledge and capital-intensive service sectors. First, there is difference in quality, nature and measurability of assets in these two categories of service firms. Second, there is a difference in the degree of uncertainty associated with asset valuation. For knowledge-intensive service firms, there are many valuation concerns related to the valuation and quality of knowledge-based assets, such as patents and trademarks (Chi, 1994; Coff, 1999). There are also concerns about the transferability and assimilation of assets of knowledge intensive targets with the acquiring firm (Zander & Kagut, 1995). Additionally, most of the intangible assets in knowledge-intensive service firms are proprietary and there is hardly any market to benchmark against or estimate a valuation. Thus, the valuation of these assets is both subjective and challenging and may get accentuated in an uncertain context such as cross-border M&As (Malhotra & Gaur, 2014). In contrast, for capital-intensive service firms, valuation can be done on the basis of external markets (e.g. market to book ratio).

An uncertain environment creates complexity, which can provoke negotiation rigidity and intensify the impact of cultural differences. Moreover, trust deficits (Very & Schweiger, 2001) that emerge as manifestations of cultural difference can accentuate information asymmetry, which is a main cause of deal abandonment (Jemison & Sitkin, 1986). A rich body of literature in cross-cultural psychology suggests that under conditions of uncertainty and ambiguity, tendency of the people to respond in accordance with their cultural attributions gets amplified (Ravlin, Thomas, & Ilsev, 2000). Therefore, for cross-border M&A deals of knowledge-intensive service firms, the effect of cultural differences might be exacerbated by the heightened need for sufficient and reliable information to deal with any ambiguous conditions. Thus given the high level of uncertainty associated with cross-border M&A deals of knowledge intensive service firms, the negative impact of cultural distance will be higher for such firms as compared to the capital intensive service firms. Accordingly we hypothesize:

**Hypothesis 2.** The firm’s industry affiliation moderates the relationship between cultural distance and likelihood of deal abandonment such that the effect of cultural distance is less severe for capital-intensive service firms than for knowledge-intensive service firms.

### 3. Methods

#### 3.1. Empirical context

We test our hypotheses using data cross-border M&As of Indian firms. Despite their lack of experience with formal and informal institutions in many host countries, firms from emerging markets (EM) have been aggressively expanding into international markets through cross-border M&As (Luo & Tung, 2007; Stucchi, Pedersen, & Kumar, 2015). However, many of the cross-border deal attempts are abandoned. Our analysis of the cross-border deals of firms from eight EM (Brazil, Russia, China, India, Mexico, South Africa, Turkey, Indonesia) during 2001–2010 time period reveals that about 25% of these deals were abandoned.

The service sector in India comprises both knowledge-intensive and capital-intensive firms. In 2011, the global value addition from the services sector was close to US$47.4 trillion, with India being ranked tenth in this total value addition (Economic Survey, 2012). Service sector in India has emerged as a prominent sector in terms of its contribution to national income, employment, and inward and outward foreign direct investments (Sun, Peng, Ren, & Yan, 2012). The deregulation in India’s institutional landscape, in 1991, and the financial liberalization policies in the late 1990s boosted the overseas expansion of Indian firms, including professional services firms (Popli & Sinha, 2014; UNCTAD, 2004a, 2004b). Indian reforms followed a temporal pattern with two distinct phases: (i) a permissive policy phase in 1991–2003, in which minority ownership requirements were lifted and the rules for overseas investments were gradually relaxed, followed by (ii) a liberal policy phase after 2003, which was more conducive to cross-border M&A activity (Gaur, Kumar, & Singh, 2014). Because cross-border M&A deal attempts by Indian firms prior to 2001 were rare, we chose 2001–2010 as our study period.

#### 3.2. Sample

For data related to the cross-border M&A deals, such as their announcement date and the standard industrial classification codes of the acquirer and target firms, we relied on the Thomson

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**Note:** The table below illustrates international paths of two example firms:

<table>
<thead>
<tr>
<th>Year</th>
<th>t0</th>
<th>t1</th>
<th>t2</th>
<th>t3</th>
<th>t4</th>
<th>t5</th>
<th>t6</th>
<th>t7</th>
</tr>
</thead>
<tbody>
<tr>
<td>Firm 1</td>
<td>A1</td>
<td>A2</td>
<td>B1</td>
<td>B2</td>
<td>B3</td>
<td>B4</td>
<td>C1</td>
<td>C2</td>
</tr>
<tr>
<td>Firm 2</td>
<td>A1</td>
<td>A2</td>
<td>C1</td>
<td>B1</td>
<td>B2</td>
<td>B3</td>
<td>B4</td>
<td>C2</td>
</tr>
</tbody>
</table>

Notes: A1, A2, B1, B2, C1, C2, and so forth, refer to any country representing cultural blocs A, B, and C.
Financial SDC Platinum database, a commonly used database for M&A studies in developed as well as emerging economy contexts (e.g., Gaur, Malhotra, & Zhu, 2013). We also performed a random cross-check of the data between the SDC database and the company annual reports and found them to be consistent.

During the ten-year (2001–2010) span of firm activity included in our study, we found 663 cross-border M&As precluding any deal with a status other than ‘completed, pending, or withdrawn’. Since characteristics of a firm’s FDI, such as entry mode and work-flow interdependence govern the resultant cultural friction (Luo & Shenkar, 2011), we considered only the majority stake M&A deals of the focal firm where the acquiring firm takes more than 50% controlling stake. With a majority stake, there is a higher degree of integration across most functional areas of the involved firms. Higher integration implies greater friction and, hence, a higher degree of learning for firms’ managers, which must interact with various host country stakeholders, including employees, suppliers, distributors, customers and others (Luo & Shenkar, 2011). For the same reasons, we did not include M&A deals with a deal value of less than US$1 million. We also had to filter out various deals which were carried out by public sector government firms or private investment firms; deals involving acquisition of own subsidiaries; deals in which the acquirer was a subsidiary of a foreign firm for which the ‘sales’ value of the target firm were not reported in SDC platinum database; and deals involving the acquisition of a stake from a joint venture partner. These restriction resulted in the final sample of 332 acquisition events, involving 197 firms.

3.3 Measures

3.3.1 Dependent variable

The dependent variable is a dichotomous one, equal to ‘1’ if the deal was abandoned and ‘0’ if it was completed.

3.3.2 Explanatory variables

Cultural distance is a key explanatory variable in our models. We calculated cultural distance scores using the more recent GLOBE project over that of Hofstede’s (1980). We also used the cultural cluster classification of the GLOBE project (House, Hanges, Javidan, Dorfman, & Gupta, 2004), which assigns about 60 countries to ten cultural clusters: Anglo, Latin Europe, Nordic Europe, Germanic Europe, Eastern Europe, Latin America, sub-Saharan Africa, Arab cultures, Southern Asia, and Confucian Asia. In our final sample, out of 92 host countries for acquisitions, the GLOBE study does not group sixteen countries in any of the above 10 cultural clusters. Therefore, following existing studies (Hutzschenreuter & Voll, 2008; Hutzschenreuter et al., 2011), we analysed the similarity of each of these countries’ individually in terms of ethnic groups, religions, languages and judicial systems, according to the CIA World Fact book and assigned them the closest possible cluster. Table 2 lists the number of deals in different cultural clusters.

We calculated the values of cultural experience reserve for each firm, and for each cultural cluster using Eq. (1).

\[ \text{Cultural Experience Reserve (CER)} = \sum_{k=1}^{n} S_k \times (k \times \eta) + \sum_{m=1}^{\eta} S_m \times (m \times \phi) \] (1)

The purpose of this index is to measure the magnitude of cultural experience a focal firm has prior to a new M&A deal. This index includes the role of prior, similar experience, and the role of time. The first component in Eq. (1) accounts for all the previous M&A investments in the same country and the second component accounts for the firm’s investment across all other countries belonging to the same cultural cluster. Eq. (1) represents the value of cultural experience reserve for the focal firm, for one cluster. Similar scores were calculated for the focal firm for nine other clusters. For firms which did majority stake acquisitions before the year 2001, we include those deals for calculation of cultural experience reserve.

The stage model of international expansion attests to the role of time in organizational learning (Johnson & Vahlne, 1977; Johansson & Vahlne, 2009). Extant literature suggests that cultural learnings start slowly during year one and then increase linearly until year five, upon which it becomes asymptotic (Bhaskar-Shrinivas, Harrison, Shaffer, & Luk, 2005; Black, Mendenhall, & Oddou, 1991). In the revised Uppsala model, Johanson and Vahlne (2009) note that adjustment to a new local context may take up to five years. Thus, we modelled the index of cultural experience reserve as having a positive slope with respect to time and accounted for the role of time in cultural learning of the firm by using non-linear weights \( \eta \) and \( \phi \) (where \( \eta = 0.1, 0.2, 0.4, 0.6, 0.8 \) for year 1, 2, 3, 4, 5 and beyond; \( \phi = \eta/2 \)). We skewed these weights, since it is established in literature that experience-based learning is difficult to accumulate in the initial period as compared to later stages (Barkema et al., 1996; Bhaskar-Shrinivas et al., 2005; Black et al., 1991; Luo & Shenkar, 2011). The non-linear weights of \( \eta \) and \( \phi \) were multiplied by the count of that investment (‘K’ and ‘m’) to justify the higher rate of learnings in repeated M&As in the same cultural cluster or country.

For each firm, we determine the chronological order of its completed majority stake cross-border M&A deals to derive the value of cultural experience reserve. To include the magnitude of cultural overlap, which governs the quantum of cultural friction, we include the size of the target firm (\( S_k \) and \( S_m \)), operationalized by its sales figure (Luo & Shenkar, 2011). The value of cultural experience reserve (pertaining to all ten cultural clusters) for each firm was updated after each M&A deal.

For Hypothesis 2, we used a capital-intensive service dummy variable to divide the sample between capital-intensive service firms (coded as ‘1’). This sub-category included firms from hospitality, hospital, retail chains (restaurants and food chains), retail trade, shipping and trucking, real estate and construction, telecom service providers, and electrical utility services. We coded knowledge-intensive service firms as ‘0’ and this included firms from software and IT services, data-centres, engineering and design services and consulting, medical test and diagnostic services, media and publishing services, market research, and legal services.

6 We assign a lower rate of increase in cultural experience reserve pertaining to other countries in the cultural cluster. This is to account for the fact that cultural learning would be higher in the same country as compared with a different country of the same cultural cluster.
3.3.3. Control variables

To control for potential confounds, we incorporated a broad set of control variables. Business group affiliated firms, commonly found in emerging economies, have access to resources, such as internationally experienced managers working for sister affiliates (Gaur et al., 2014; Singh & Gaur, 2009). We controlled for this group affiliation with a dummy variable for which ‘1’ indicated a group-affiliated firm and ‘0’ implied an independent firm. Literature has argued that equity joint venture/alliance as an entry mode also provides opportunities to develop transaction-specific routines (Wang & Zajac, 2007). Additionally, the organizational learning perspective (March, 1991) emphasizes the role of alliances in building firm capabilities (Kale, Dyer, & Singh, 2002). We believe that working in a cross-border joint venture could possibly bring some cultural knowledge to the firm, similar to that gained in an M&A deal (Zollo & Reuer, 2010). Therefore, we considered prior experience of forming cross-border joint ventures by the focal firm. For this, we took count of all the completed equity joint ventures of the focal firm in the same cultural cluster.

We also controlled for formal institutional distance between India and the target firm countries. To measure institutional distance, we utilized those elements of institutional environment that are important for the cross-border M&A deal (Zaheer et al., 2012). We used the Heritage Foundation’s ‘Index of Economic Freedom’ (Kane, Holmes, & O’Grady, 2007), which includes ten sub-indices that aggregate information about approximately 50 variables. We measured environmental complexity, which represents one of the four broad categories in the index of Economic Freedom. This is known as the ‘Rule of Law’ and is an aggregate of ‘Property Rights’ and ‘Freedom from Corruption’.

The relatedness of the involved firms, in terms of their product or service, technology, target markets and market positioning, can also reduce uncertainty in M&A deal negotiations (Homburg & Buceriis, 2006). Thus, we used a dummy variable that takes the value of ‘1’ if both the acquirer and the target were in same industry classified by standard industry classification codes and ‘0’ otherwise. With two dummy variables for the acquirer’s public status and the target’s public status, we specified whether the firms involved were publicly listed (because M&As dealing publicly listed firms can evoke reactions from various stakeholders with confounding effects on deal completion). We also controlled for the equity percentage sought by the acquirer (Dikova et al., 2009).

Finally, the cultural cluster dispersion variable measured the extent to which a focal firm dispersed its M&A activities across various cultural clusters. Zeng, Shenkar, Lee, and Song (2013) note that the dispersion of investment across various cultures breaks organizational rigidities and helps firms develop broader skills, as well as foster learning in a dissimilar culture. In contrast, Hutzschenreuter and Voll (2008) argue that excessive cultural learning in a short time prevents the focal firm from further learning, due to the difficulty in assimilating knowledge in new cultural environments. Similarly, Vermeulen and Barkema (2001) indicate that the relationship between the number of foreign subsidiaries and firm performance is moderated negatively by a firm’s geographic dispersion. Thus, we included the role of dispersion in our analysis. Following Carter, Pantzalis, and Simkins (2003), we calculated dispersion as $1 - \frac{1}{N} \sum \left( \frac{n_i}{N} \right)^2$, where $n_i$ is the number of previous M&As in cultural cluster $i$, and $N$ represents the total number of a firm’s M&As in all cultural clusters.

4. Results

Table 3 presents the descriptive statistics and partial correlation coefficients for the key variables. The low correlations between the predictor variables suggest that multicollinearity is not a problem in regression models.

Table 4 contains the results of the binary logistic regression. We build the models in a hierarchical manner: Model 1 includes control variables; Models 2–4 test for the influence of our hypothesized relationships on the dependent variable. In Model 2, we used the country-level cultural distance score as the main covariate, calculated according to Kogut and Singh’s (1988) index using GLOBE scores. The coefficient of cultural distance is positive and significant ($\beta = 0.70, p < 0.01$), indicating that cultural differences between an acquirer and a target firm increase the likelihood of cross-border deal abandonment. This is similar to the results of Dikova et al. (2009) who found a negative relationship between informal institutional differences (i.e. cultural distance) and the probability of cross-border deal completion.

In Model 3, we find the coefficient of interaction between cultural distance and cultural experience reserve was negative and significant ($\beta = -0.26, p < 0.05$). Hypothesis 1 is supported. This suggests that the effect of cultural distance on deal abandonment will be reduced if a firm has higher cultural experience reserve. In other words, even with greater cultural distance, firms are less likely to abandon deals if they have higher cultural experience reserve. We also obtained better fit ($\Delta \chi^2 = 4.16, p < 0.01$) compared with Model 2. Our main thesis has been that the cultural experience reserve is a potential firm-specific capability and empirical results showcase that for the given country-level cultural distance scores between acquirer and target firm, a firm’s cultural experience reserve mitigates the negative effect of cultural differences.

In Hypothesis 2, we proposed that the positive (negative) effect of cultural distance on the likelihood of deal abandonment (completion) will be less severe for capital-intensive industries than for knowledge-intensive industries. The coefficient for the capital-intensive sector dummy variable was significant and

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<td>Descriptive statistics: means, standard deviations, and correlations.</td>
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Notes: N=332, correlations with absolute values greater than 0.1 are significant at $p < 0.05$. 

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We examine the above noted issues in the context of cross-border M&A deal abandonment. We analysed the chronological pattern of the cross-border M&A activity of 197 Indian service sector firms during 2001–2010. Based on the extant literature, we argued that cross-border M&A activity is a complex international economic transaction (Malhotra & Gaur, 2014) and is impacted by formal as well as informal constraints (North, 1990). Indeed, cultural differences aggravate the level of uncertainty and information asymmetry and are a major impediment to the cross-border M&A deal completion (Dikova et al., 2009).

Drawing from the literature on organizational learning and cultural friction perspective (Shenkar et al., 2008), we posit that managing and integrating an acquisition results in cultural learning for the focal firm (Levitt & March, 1988; March, 1991). Shenkar (2001; 2012) has emphasized the role of foreign experience as a means to close cultural distance between two entities. To advance the literature in this domain, we developed the construct of cultural experience reserve, which incorporates the role of cultural similarity of the targets as well as time (Hutzschenreuter et al., 2011). A longitudinal approach and path-related perspective in M&A research enables scholars to include the role of time and similarity of a company's prior acquisition experience to the focal acquisition (Stahl & Voigt, 2008). The notion that a great deal of cultural experience is indispensable in overcoming any cultural incompatibilities in cross-border M&A deals is well received in the extant literature (Very et al., 1997; Weber, Shenkar & Raveh, 1996). We argue that cultural experience reserve is a dynamic firm-specific capability, which increases as the organization acquires experience. For each acquiring firm we calculate a value of cultural experience reserve for each cultural cluster, which is updated with every subsequent M&A. Our empirical tests support that firm's cultural experience reserve positively moderates the relationship between static scores of country-level cultural distances and cross-border M&A deal abandonment.

Our results also supports the thesis that industry context sets boundary conditions for the impact of cultural differences on the probability of deal abandonment. Our findings suggest that the effect of cultural distance is more severe in the case of knowledge-intensive service firms due to higher uncertainty associated with these firms as compared to capital-intensive service firms. These finding corroborate with those of Lee, Shenkar, and Li (2008) in which they found that the direction of investment flow moderates the relationship between country-level cultural distance scores and the level of control sought in a joint-venture.

We contribute to the literature by emphasizing the heterogeneity in the impact of cultural differences as a response to address the concerns related to the linear, static and homogenous effect arising due to the use of ubiquitous constructs of cultural distance scores (Shenkar, 2001; Shenkar et al., 2008; Tung & Verbeke, 2010; Zaheer et al., 2012). We attempt to highlight the tenuous connection of cultural distance construct with organizational outcomes and propose that it can be better predicted by accounting for heterogeneity across firms. With this study, we also respond to the call from Luo and Shenkar (2011) to investigate the processes and outcomes of cultural friction in cross-cultural negotiations. Additionally, our secondary contribution is to add to studies on cross-border deal abandonment in an EM context. Given that firms from EM economies embark upon riskier and non-evolutionary paths of cross-border M&As to augment their resources (Luo & Tung, 2007), it is imperative to make a case to understand the reasons for M&A deal abandonment.

5.1. Managerial relevance

Given the substantial importance of cultural differences in globalization, this study provides some key inputs to managerial
practice. This study suggests that cultural experience reserve, arising out of prior M&A experience, is an important firm-specific capability that can reduce the impact of cultural difference between home and host countries. Consistent with managerial belief, this study demonstrates that the impact of cultural differences is not homogeneous across all firms and is a function of prior experience. The outcome of this study, similar to Cuypers and Martin (2010), showcase that uncertainty arising out of cultural difference is endogenous to firms.

Furthermore, we detail boundary conditions that allow practicing managers to anticipate the contextual effects of cultural differences. Slangent and Beugelsdijk (2010) found that the impact of institutional (both informal and formal) hazards is contingent upon the type of international activity (horizontal or vertical). Similarly, we hypothesize and find that the impact of cultural differences gets accentuated in M&A attempts of knowledge-intensive firms. Therefore, managers should be aware of the subtle, yet important contingent factors that exist in order to be prepared for more sensitive cross-cultural settings. This study shows that there is a possibility to calculate the impact of cultural differences on a case-to-case basis rather than generalizing it with popular heuristics and beliefs. Finally, our research emphasizes and confirms the importance of cultural differences in cross-border M&A and negotiations. Deal abandonment is costly not only in terms of explicit costs but also in terms of damage to the focal firm’s global reputation and image (Luo, 2005). Indeed, managers should not underestimate cultural issues in the intermediary phase of cross-border M&A deals (ex ante phase) as unclear expectations and other integration issues in this ex ante period can potentially create trouble in ex post phase (integration phase).

5.2. Limitations and scope for future research

In closing, we highlight the limitations in our research and suggest areas for future research. Several scholars have given a call to address the complexity of cultural distance constructs by conducting more interdisciplinary research (Stahl & Voigt, 2008; Zaheer et al., 2012). We are hopeful that the cultural friction perspective has the potential to help unravel such research questions. It would also be interesting to investigate its applicability to other organizational decisions that are ex ante in nature, such as the entry mode or ownership control decisions related to FDI. Furthermore, we can enrich our understanding by considering the prior experience of the other party, whose international experience could also mitigate the impact of cultural distance. There is an implicit assumption in our theoretical model and empirical analysis that the rate of learning, and its diffusion, is uniform across all organizations. One could argue that the rate of learning across firms might be contingent on different modes of acculturation, type of industries or even specific countries (Luo & Shenkar, 2011). We believe case-study based longitudinal research approach can further help to find answers to these inquiries.

References


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