

RESEARCH BRIEFS

DOES CULTURE INFLUENCE CORPORATE RISK TAKING?

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RESEARCH QUESTIONS

In this era of globalization and homogenization, does culture still play a role in predicting corporate risk-taking behavior? And if so, how exactly does culture impact corporate decisions? Are there certain aspects of a culture that are more influential than others in terms of shaping corporate risk taking? Does culture directly influence corporate strategies or does it have more of an indirect affect? Moreover, does the impact of culture vary across corporations and do firm characteristics matter?

Scholars in a variety of disciplines have been debating these questions for years. Some scholars discount the importance of culture in understanding corporate behavior. For instance, some economists argue that corporate decisions should be explained by profit maximization arguments rather than by intangible factors like culture. However, others believe context does matter and that culture affects corporate behavior, including risk taking. If this is the case, then it is natural to ask whether cultural impact is direct or indirect. In other words, does the cultural impact on the formation of national institutions matter more than the impact culture has on managerial attitudes in terms of predicting corporate risk-taking behavior? Previous empirical research has been inconclusive about the question of whether cultural characteristics directly or indirectly shape corporate risk taking.

Departing from prior research, Kai Li and Dale Griffin (University of British Columbia) and Heng Yue and Longkai Zhao (Peking University) examined both the direct and indirect ways in which culture can influence corporate risk taking. On the indirect side, Li and his colleagues examine whether a country's formal institutions—which are shaped by cultural factors—affect corporate risk taking. Cultural values such as individualism and uncertainty avoidance may lead to different legal frameworks as well as different laws concerning investor protection and creditor rights, which in turn may affect corporate risk taking. For example, more individualistic countries have legal systems that promote individual freedom and autonomy, which may encourage corporate risk taking via legislation

that protects the shareholder and creditor rights. The opposite could be true in countries that have higher levels of uncertainty avoidance and are more harmonious. In these countries, less corporate risk taking may occur because of legal proscriptions that discourage such behavior.

On the indirect side, Li and his colleagues also examined how these cultural values (individualism, uncertainty avoidance, and harmony) can shape *managerial* attitudes toward risk taking. Individualistic managers may be more likely to take risks to distinguish themselves from other managers while underestimating the risks that they face. Managers who have low uncertainty avoidance and low harmony should also be comfortable with change, conflict, and making risky decisions. In contrast, managers in countries with high uncertainty avoidance and more harmony may be very uncomfortable with making risky decisions. Finally, corporate factors may also come into play. Li and his colleagues suggest that culture will have more of an impact when managers have more discretion. And discretion tends to be greater in smaller firms. Consequently, managers in smaller firms should be more likely to engage in riskier behavior compared to their counterparts in larger firms (which typically have more management control systems in place that act to constrain managerial behavior).

STUDY DESIGN AND METHODOLOGY

Li and his colleagues used data that came from a sample of 7,250 manufacturing firms in 35 countries over a nine-year period (1997-2006). To measure corporate risk taking, the researchers first developed a general measure of risk taking. For this they used the standard deviation of the return on assets for each firm. They then developed a measure of risk taking in terms of long-term corporate investment. For this they calculated average R&D expenditures divided by total assets. Measures of cultural values were drawn from work by Hofstede (1991, 2004) and Schwartz (1994, 2004). To evaluate a country's formal institutions, Li and his colleagues relied on a variety of measures (e.g., legal protections for investors,

a creditor rights index, indices of economic development). In analyzing their data, Li and his colleagues used statistical techniques well suited for distinguishing between firm-, individual-, and country-level effects of culture on risk-taking behavior.

KEY FINDINGS

The results supported the idea that cultural attributes directly affect corporate risk taking, especially when managers have more discretion. Firms in more individualistic countries took more risks than firms in countries that emphasize harmony and have higher levels of uncertainty avoidance. Initially, Li and his colleagues found little evidence that culture impacts corporate risk taking indirectly via formal institutions (e.g., legal frameworks). After some additional digging, however, Li and his colleagues found that cultural values do in fact influence the types of institutions that develop within a country. Individualistic countries rely more on formal institutions to protect individual rights and, as a consequence, a positive relationship exists between the type of law and firm disclosure. In countries with high levels of uncertainty avoidance, there is more emphasis on conformity and granting power to authorities, but less reliance on judicial proceedings and disclosure. Lastly, in countries where harmony is highly valued, accommodating to the status quo is prized. As a result, the rule of law is emphasized, but little interest exists in protecting minority shareholders and creditors.

In summarizing the results, Li and his colleagues offer some important insights about the role of culture in the global economy. First, corporations involved in international business should be proactive in terms of understanding the multiple channels through which culture can influence business decisions. This information is important in terms of understanding the decisions of competitive firms in a host country, as well as how formal institutions in a host country may enhance or constrain domestic and/or multinational corporations' decisions. This study makes it clear that cultural characteristics directly shape managerial attitudes with respect to risk taking, especially in firms where managers have more discretion. Second, the institutional environment shaped by cultural factors also has an impact on how a firm weighs the benefits and costs associated with risk-taking behavior.

CONCLUSION AND IMPLICATIONS

While this study makes some important contributions in extending previous research on the impact of culture on corporate decision making, there

are some significant questions that remain with respect to analyzing cultural effects. First, while Li and his colleagues note that examining the impact of culture at the firm level is an important channel to pursue, they also acknowledge that, due to data limitations, their study did not look at this relationship. Future research may want to extend recent efforts with respect to how culture affects firm-level decisions such as corporate compensation schemes. Second, Li and his colleagues chose to primarily focus on a small set of cultural values in analyzing the relationship between culture and corporate decision making. They did briefly examine whether masculinity and power distance (two additional cultural values) have a direct impact on corporate risk taking, but did not find any significant results. Nevertheless, it would be interesting to expand this line of investigation by assessing whether other cultural attributes may have an indirect effect on corporate behavior.

Along the same lines, while Li and his colleagues contend that cultural values change relatively slowly, it may be that the pace of cultural change, at least in certain parts of the world, is accelerating as globalization intensifies. Moreover, research on culture, such as the GLOBE Project (Javidan & House, 2001, 2002) provides a more comprehensive and integrated assessment about research on national cultural attributes (GLOBE has surveyed more than 17,000 managers from 951 organizations in 62 countries). Although several of GLOBE's cultural dimensions overlap with existing frameworks, such as that used by Hofstede, new cultural dimensions such as assertiveness and performance orientation have emerged that may be relevant for understanding the impact of culture on corporate risk taking. Likewise, this study could be expanded to examine other types of corporate decisions and other measures of corporate risk taking. Finally, a number of studies have looked at whether host or home country cultures have a bigger impact on the subsidiary behavior of multinationals. Li and his colleagues may provide a premise for extending this work, suggesting that we should examine the tradeoffs between the institutional frameworks in home and host countries to discern how they both shape decision making in foreign subsidiaries.

In conclusion, Li and his colleagues' research has important implications for finance and accounting in showing that a corporation's international context matters. In addition, their work has significance for international management by identifying the channels through which culture can affect corporations. Their findings provide support for institutional theory, which argues that institutions matter in terms of predicting cross-national differences

between corporations (Matten & Moon, 2008). But Li and his colleagues have also shown us that the story is more complex than just looking at institutional differences. In a nutshell, we need to understand the cultural forces that shape the institutional frameworks in different countries. The underlying message is that the cultural context of countries matters and is key to understanding corporate risk taking in international business.

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