

# Cultural differences and capability transfer in cross-border acquisitions: the mediating roles of capability complementarity, absorptive capacity, and social integration

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## Abstract

This paper presents an integrative model of the impact of cultural differences on capability transfer in cross-border acquisitions. We propose that cultural differences affect the post-acquisition capability transfer through their impact on social integration, potential absorptive capacity, and capability complementarity. Two dynamic variables – the use of social integration mechanisms, and the degree of operational integration of the acquired unit – are proposed to moderate the effects of cultural differences on social integration and potential absorptive capacity. The implications for acquisition research and practice are discussed.

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## Introduction

Companies have spent trillions of dollars on acquisitions that have transformed industries and affected the lives of millions. However, in spite of their popularity and strategic importance, the performance of many acquisitions has been disappointing. A metaanalysis of 93 studies with data on 206,910 acquisitions revealed that the post-acquisition performance of acquiring firms fails to surpass or tends to be slightly poorer than that of non-acquiring firms (King et al., 2004). Furthermore, the variables most commonly used in empirical research to predict acquisition performance – degree of diversification of the acquirer, the extent to which the acquirer and acquired firms are related, method of payment, and prior acquisition experience – failed to explain variance in post-acquisition performance. This led King et al. (2004) to conclude that ‘research has not clearly identified those variables that impact an acquiring firm’s performance’ (p: 196). More theory development is clearly needed to shed light on factors that may contribute to post-acquisition performance, including factors related to the process of

human (Birkinshaw et al., 2000) or sociocultural (Shrivastava, 1986; Stahl and Voigt, 2005) integration that are currently under-represented in theory and research.

Merger and acquisition (henceforth, acquisition) researchers have argued that acquisition failures are often due to problems combining the different cultures and workforces during the integration phase. Clashes between different organizational values and practices, and ‘us vs them’ thinking among the employees in the merging organisations, may lead to lack of collaboration and failed opportunities for interunit learning (Cartwright and Cooper, 1996; Nahavandi and Malekzadeh, 1988; Schweiger, 2002). Problems may be exacerbated when acquisitions occur between companies based in different countries. Foreign language problems, different legal systems, regulatory hurdles, and national cultural barriers can be major obstacles to achieving integration benefits (Olie, 1994; Vaara, 2003; Aguilera and Dencker, 2004; Shimizu et al., 2004).

However, empirical findings about the impact of cultural differences on acquisition integration outcomes are mixed, and a positive relationship between cultural differences and measures of postintegration performance has sometimes been reported (e.g., Weber et al., 1996; Larsson and Risberg, 1998; Morosini et al., 1998). A recent meta-analysis of the existing body of research (Stahl and Voigt, forthcoming) suggests that cultural differences account for only a small proportion of the variance in post-acquisition integration outcomes. These findings suggest that the relationship between cultural differences and post-acquisition performance is complex, and that unidentified moderator variables might be obscuring the effect of cultural differences on acquisition performance. Further theoretical and empirical work is needed on how cultural differences impact on acquisition performance, and on factors that augment or reduce the performance effects of cultural differences in acquisitions.

In this paper we develop a model that helps to clarify some of the mixed findings of previous research, and may thus serve as a useful basis for future research. Our starting point is to focus on acquirer–target cultural differences, which encompass differences in beliefs, values, and practices between the combining organisations or units. We then focus on the mechanisms through which cultural differences affect the transfer of the merging companies’ capabilities, one of the central processes that destroy or create value

in acquisitions (Haspeslagh and Jemison, 1991). We build on the large body of research on knowledge and capability transfer in multinational corporations (MNCs), as well as on work on post-acquisition integration, to develop an integrative model that describes the mechanisms by which cultural differences affect the extent of capability transfer in cross-border acquisitions.

### **Theoretical background**

It is today commonly accepted that an important competitive advantage of MNCs is their superior ability to transfer and combine capabilities across geographically dispersed units (Grant, 1996; Gupta and Govindarajan, 2000; Doz et al., 2001). This view highlights the significant role of foreign subsidiaries (Birkinshaw and Hood, 1998) – units often established through acquisitions – as both providers and receivers of knowledge in the ‘differentiated’ MNC (Nohria and Ghoshal, 1994). This reasoning is consistent with strategy research indicating that redeployment of complementary resources between the acquiring and acquired units contributes to superior financial performance (Capron, 1999; Capron and Pistre, 2002).

We propose in this paper that a moderate level of cultural differences will be positively associated with the units possessing complementary capabilities, the existence of which are likely to be positively associated with the extent of capability transfer between the two organisations subsequent to the acquisition. Hence we posit that access to complementary capabilities (Harrison et al., 2001; King et al., 2003) will mediate the effect of cultural differences on the post-acquisition capability transfer.

Research has also uncovered a range of barriers to interunit capability-sharing across MNC units (e.g., Szulanski, 1996; Gupta and Govindarajan, 2000; Foss and Pedersen, 2002; Schulz, 2003). In this paper we focus on the influence of two factors on capability transfer: the degree of social integration, and the ability of the organisations involved in the acquisition to absorb capabilities from each other. We argue that both social integration and absorptive capacity mediate the effect of cultural differences on the post-acquisition capability transfer. Furthermore, we propose that two aspects of the integration process – the use of social integration mechanisms and the degree of

operational integration – moderate the effects of cultural differences on social integration and absorptive capacity.

### **Beyond the cultural distance paradigm**

In the international and cross-cultural management literatures, differences between national cultures have frequently been conceptualised in terms of ‘cultural distance’ (e.g., Kogut and Singh, 1988; Morosini et al., 1998; Shenkar, 2001). The cultural distance hypothesis, in its most general form, suggests that the difficulties, costs and risks associated with cross-cultural contact increase with growing cultural differences between two individuals, groups or organisations. Cultural distance is commonly measured in terms of differences in work-related values using the Kogut and Singh (1988) index, a composite measure of Hofstede’s (1980) dimensions of national cultures. The cultural distance construct has been shown to be significantly related to the choice of foreign entry mode and the perceived ability to manage foreign operations (e.g., Kogut and Singh, 1988), organizational learning across cultural barriers (e.g., Barkema et al., 1996), and the longevity of global strategic alliances (e.g., Parkhe, 1991).

In the context of acquisitions, it has often been argued that cultural distance poses a major obstacle to achieving post-acquisition integration benefits (e.g., Buono and Bowditch, 1989; Olie, 1990; Cartwright and Cooper, 1996). Cross-border acquisitions appear to be particularly difficult to integrate because they require ‘double-layered’ acculturation (Barkema et al., 1996), whereby not only do different organisational cultures have to be combined, but differences in national cultural values and practices pose additional problems to successful integration.

While this appears to be an intuitively plausible assumption, supported by a myriad of anecdotal evidence, the growing body of empirical research on the impact of cultural distance on M&A outcomes has yielded inconclusive – and often contradictory – results (for recent reviews see Schoenberg, 2000; Schweiger and Goulet, 2000; Stahl and Voigt, 2005; Teerikangas and Very, 2006). Some studies found national cultural distance to be negatively related to measures of post-acquisition performance, but others found cultural distance to be unrelated or even positively related to acquisition performance

(e.g., Morosini et al., 1998). Thus the assumptions underlying the ‘cultural distance’ hypothesis either do not apply to acquisitions or are too simplistic to explain the effects of cultural differences on post-acquisition integration outcomes.

It has been argued that the inconsistent results obtained in research using cultural distance as the independent variable may be due to problematic assumptions about the conceptual and methodological properties of the cultural distance construct, such as the use of cultural distance as a composite variable (for a critique see Shenkar, 2001; Dow and Karunaratna, 2006; Drogendijk and Slangen, 2006). Furthermore, as Harzing (2003) has pointed out, national cultural differences are usually confounded with language and institutional differences as well as economic, legal and political differences. In post-acquisition performance research these confounding variables may unduly affect the results and threaten the validity of inferences about the effect of cultural distance on acquisition outcomes. Other conceptual and methodological problems that arise in studies with a limited focus on national cultural distance include: a lack of attention to cultural elements other than work-related values; the widespread but largely unsubstantiated assumption that differences in national cultural values have a more pervasive impact on acquisition outcomes than differences in organisational culture; and a lack of consideration of the dynamic interplay between different dimensions of cultural differences (Stahl and Voigt, 2005; Teerikangas and Very, 2006).

These concerns deserve attention, particularly in light of research that suggests that post-acquisition integration outcomes are affected not only by cultural differences at the national and organizational levels, but also by differences in professional, functional, and industry cultures (David and Singh, 1994; Schweiger and Goulet, 2000). For example, David and Singh (1994) studied cases of mergers between firms in the same industry with the same national culture, and found that differences in professional culture (private sector vs government owned) contributed to problems in post-acquisition coordination. In another case study, they held the degree of national, organisational and professional cultural distance constant and recorded varying acculturation outcomes for different business units in the acquired firm (R&D, production), depending on the mode of integration. National cultural distance was irrelevant in the case of the largely

autonomous R&D units, but was fully operative in the case of the more closely integrated production units.

In summary, previous M&A research with a focus on cultural distance has been overly simplistic in assuming that national cultural differences affect acquisition outcomes in isolation from other integration-related processes. To further advance our understanding of the performance implications of cultural differences in acquisitions, we need both a more sophisticated conceptualisation of ‘cultural differences’ and a more accurate mapping of the mechanisms linking these differences to acquisition performance.

In the management literature, culture has been conceptualised in a variety of ways: as a system of shared symbols and meanings (Smircich, 1983); as existing simultaneously at the levels of artefacts, espoused values, and basic assumptions (Schein, 1985); as strategies of action (Swidler, 1986); and as a set of rules that govern identity or identification (Fiol, 1991). The conceptualisation of culture adopted in this paper extends the national/organizational distinction by viewing MNCs as cultural systems where beliefs, values and practices form specific configurations in particular parts of the corporation. From this perspective, merging units can be seen as specific cultural configurations embedded in their particular contexts (national, industrial, etc.). This conceptualisation of culture is consistent with Schein’s (1985) widely used levelsof-culture model, and it is applicable to both national and organisational cultures (in fact, to all cultural systems). It also coheres with Hofstede’s (1980) ideas about underlying world views that are manifested in a ‘collective programming of the mind’ and actual behaviour, as well as the multilevel concept of culture adopted by the GLOBE research programme (House et al., 2004).

### **Impact of cultural differences on capability transfer**

A common theme in acquisition research is that superior performance in related acquisitions can only be achieved if the organisational combination leads to synergy, whereby, in combination, the two organisations create more value than each could achieve alone (Schweiger and Walsh, 1990; Haspeslagh and Jemison, 1991). Larsson and

Finkelstein (1999) argue that the synergy potential of an acquisition is a function of both similarities and complementarities between the two firms involved in the acquisition – different products, market access, or know-how that fit with and enhance one another. However, it has been argued that synergistic benefits are more likely to produce abnormal returns when based on complementarities rather than on similarities (Harrison et al., 2001). Barney (1988) suggested that an acquisition creates value for the acquirer when it adds unique and valuable resources that can be leveraged into the target organisation, and Harrison et al. (1991) provided evidence that complementarities – but not similarities – are associated with superior acquisition performance. Combinations of complementary capabilities cannot easily be duplicated by other firms, and may thus provide the acquirer with the possibility of earning abnormal returns from the acquisition. Hence the focus in this paper is not on the potential for restructuring and cost cutting that arises from overlapping activities but rather on the potential for value creation associated with complementary capabilities. Complementary capabilities are capabilities that reside in the merging organisations that ‘are not identical, yet they simultaneously “complement” each other’ (Harrison et al., 2001: 680); in other words, they are capabilities whose values are enhanced by transfer and combination (Buckley and Carter, 2004). Two merging organisations may complement each other in different ways, spanning capabilities residing in different functions and parts of the organizations and possibly covering different parts of the value chain, and there may be both direct and indirect effects of combining the two units (cf. Richardson, 1972; Milgrom and Roberts, 1990).

Our focus on capability transfer is consistent with Haspeslagh and Jemison’s (1991) and Jemison’s (1988) model of value creation in acquisitions. According to this model, the objective of relatedbusiness acquisitions is to improve the competitive position of one or both of the firms by the transfer of complementary strategic capabilities between them. In this paper we use the term ‘capability transfer’ to denote the acquired or acquiring unit’s use of tacit and explicit knowledge, including tools and processes (Chaudhuri, 2005), which originate in the acquiring or acquired organisation. We do not propose that a capability transfer entails a ‘perfect’ replication in the receiving unit (cf. Argote and Ingram, 2000), but rather that the transfer leads to a transformation and/or exploitation of knowledge by the recipient (cf. Zahra and George, 2002) that

combines it with its existing capabilities. The transfers may entail adding capabilities to those possessed by the receiving unit but also processes of sequential development and combination of knowledge and capabilities and complex interaction among the units in question (Buckley and Carter, 1999, 2004)

Capron's work on value creation in horizontal acquisitions by US and European firms renders support to this reasoning. Capron et al. (1998) found that the relative strength of the merging firms along several resource dimensions – including technical innovation capabilities, manufacturing know-how and managerial capabilities – affected the redeployment of these resources in the other firm. In another paper, Capron concludes that the post-combination use of resources from the acquirer in the target organisation, and to some extent vice versa, contributed to acquisition performance (Capron, 1999). Capron and Pistre (2002) found that transfers of resources from the acquirer to the target were associated with abnormal returns, while transfers from the target to the acquirer did not ensure value creation. Overall, these results suggest that firms involved in acquisitions tend to transfer complementary capabilities to the target and/or acquiring unit, and that these transfers are important for the ultimate outcome of the acquisition.

Apart from the existence of complementary capabilities, which factors contribute to post-acquisition capability transfer? In recent years scholars within strategy, management, and international business research have extensively studied knowledge and capability transfer within and between corporations. International business researchers have increasingly moved towards viewing the MNC as an interorganisational network of geographically dispersed and differentiated units (Hedlund, 1986; Bartlett and Ghoshal, 1989; Ghoshal and Bartlett, 1990; Nohria and Ghoshal, 1997), whose *raison d'être* lies in the ability to exploit resources – especially capabilities– more efficiently internally than would be possible through external market mechanisms (Zander and Kogut, 1995). In exploring this issue, a range of barriers to and enablers of capability transfer has been uncovered (Szulanski, 1996; Gupta and Govindarajan, 2000; Schulz, 2001, 2003; Bjo'rkman et al., 2004). In addition to factors related to the type of knowledge or capabilities involved, barriers to transfer include motivational factors associated with both the sending and the receiving unit (Szulanski, 1996; Gupta and Govindarajan, 2000), indicating that cooperative and cohesive behaviour of the units involved in interunit

capability transfers is crucial for the effective functioning of an MNC. In the model developed in this paper, we posit that, first, the level of social integration between the acquiring and the acquired firms and, second, the recipient organisation's potential capacity to absorb capabilities from the other unit will mediate the effect of national cultural differences on the interfirm capability transfer.

A central aim of social integration, or socialisation, is to establish a shared set of values and objectives across MNC units (Nohria and Ghoshal, 1994), providing them with a strong sense of a shared identity and mission (Hedlund and Kogut, 1993; Kostova, 1999). The existence of extensive and strong interpersonal relationships across MNC units also both contributes to and serves as a symbol of social integration (Kostova and Roth, 2003). For the purpose of this paper, social integration is conceptualised as the creation of a shared identity, the establishment of trusting relationships, and the absence of divisive conflicts between the members of the combining organisations. From a capability-sharing perspective, the underlying rationale is that to the extent that different units are socially integrated, they are more likely to exchange complementary knowledge needed to pursue their shared vision (Nahapiet and Ghoshal, 1998).

In an important conceptual paper, Zahra and George (2002) proposed that two subsets of absorptive capacity exist: potential absorptive capacity and realised absorptive capacity. Potential absorptive capacity consists of the organisation's capacity to acquire and assimilate knowledge, and realized absorptive capacity centres on knowledge transformation and exploitation. We propose that potential absorptive capacity is an important intermediate variable between cultural differences and the extent of capability transfer following acquisitions.

## **Theoretical model**

Figure 1 presents the model developed in the following sections. Proceeding from left to right, the model suggests that cultural differences affect the post-acquisition capability transfer through their impact on social integration, potential absorptive capacity, and capability complementarity. Furthermore, the model proposes that the effects of cultural

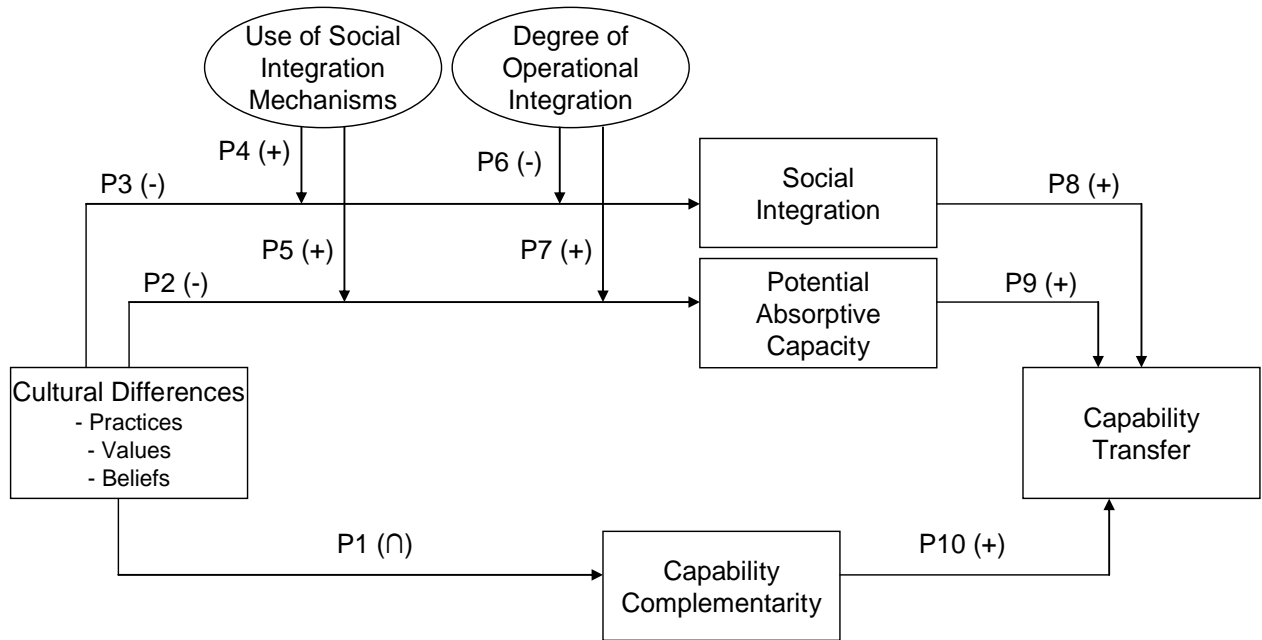
differences on social integration and absorptive capacity are moderated by the use of social integration mechanisms and the degree of operational integration.

### **Capability complementarities**

International acquisitions combine units from different cultural contexts. It has been persuasively argued that organisational capabilities are embedded in the national environment in which the firm operates. For instance, ways to interact with business partners, how to perceive the business environment, processes for allocation of organisational resources, human resource management policies and practices, characteristics of innovation processes, and the technologies, products and services developed and exploited tend to differ across national cultures (Hofstede, 1980; Fiol, 1991; Schneider and DeMeyer, 1991; Shane, 1993). Cross-border acquisitions thus provide the acquirer and the acquired unit with access to a potentially valuable repository of capabilities embedded in the local environment (Jemison and Sitkin, 1986; Ghoshal, 1987). As Morosini et al. (1998: 141) have noted, a cross-border acquisition can be interpreted as ‘a mechanism for the acquiring (or the target) firm to access different routines and repertoires that are missing in its own national culture, and which have the potential to enhance the combined firm’s competitive advantage and performance over time’. According to Morosini et al. (1998), acquisitions in culturally distant countries are more valuable, because a greater cultural distance makes it more likely that the target firm will have capabilities that are significantly different from the acquirer’s own set: thus, *Ceteris paribus*, complementarities are more likely to exist.

### FIGURE 1

#### Factors Influencing Capability Transfer in Cross-Border Acquisitions



Further support for a positive relationship between national cultural differences and capability complementarity comes from research adopting an organisational learning perspective on acquisitions. For example, research conducted by Barkema and Vermeulen (1998), Vermeulen and Barkema (2001) suggests that differences in cultures and systems may break rigidities in acquiring firms, help them to develop richer knowledge structures, and foster innovation and learning.

However, when the cultural differences between the merging parties become too large, the level of complementarity is likely to decrease again. The issue here is the extent to which the capabilities of the two units complement each other: that is, to which they are relevant for and therefore add value to each other. As pointed out by Lazear (1999) in the context of multicultural teams, the two parties may be so different as to make it

unlikely that they possess capabilities that are relevant for each other. Moreover, with growing cultural distance, the likelihood increases that the combining firms' practices are incompatible and lead to implementation problems (Slangen, 2006; Stahl and Voigt, forthcoming). We therefore propose that cultural differences are most likely to lead to complementary capabilities that fit with and enhance one another when they are moderately large. As an example, if the acquired firm does not share key values and practices, then it seems unlikely that it can add valuable strategic capabilities that can be leveraged by the acquirer; if, on the other hand, the target firm's values and practices are very similar to those of the acquirer, it is unlikely that the acquisition will add unique capabilities and create value. When taken together, these arguments suggest a curvilinear relationship between cultural differences and capability complementarity.

Proposition 1: There is a curvilinear relationship between cultural differences and capability complementarity, such that moderately large cultural differences will be associated with higher levels of capability complementarity between the acquiring firm and the acquired firm.

### **Absorptive capacity**

The problems involved in transferring knowledge among organisations located in culturally distant environments have been widely acknowledged in the literature (Bhagat et al., 2002). We argue that the potential absorptive capacity (Zahra and George, 2002) can be considered an important intermediate variable between cultural differences and knowledge transfer in acquisitions. The focus here is on the receiving unit's potential capacity to acquire and assimilate capabilities from the other unit (cf. Lane and Lubatkin, 1998) rather than on its potential capacity to absorb capabilities from other sources or in general. Following Minbaeva et al. (2003) we argue that potential absorptive capacity consists of both motivation and ability on the part of the receiving organisation to acquire and assimilate capabilities. Several factors may account for the negative relationship that we propose to exist between cultural differences and the recipient's potential absorptive capacity.

First, the greater the cultural differences between the sender and the recipient unit, the less likely the acquiring and acquired units are to search for possibilities to transfer capabilities from one unit to the other. Instead of looking for ideas in the other unit (cf. Cyert and March, 1992), the search for possibilities for knowledge-sharing is more likely to take place among units that are culturally closer to the own organisational unit. In other words, attention to and knowledge of the capabilities residing in the other unit are likely to be negatively related to the cultural differences between the two organisations, leading to a lack of motivation to initiate processes of interunit capability transfer.

Second, in cases when people in the two organizations do possess knowledge of the capabilities of the other unit, the cultural differences between the two units are likely to influence the extent to which the receiving unit perceives the nature of knowledge residing in the other organization as unambiguously valuable for its own operations (Simonin, 1999). The greater the cultural differences, the more difficulties people in the receiving unit may have in evaluating the potential advantages stemming from the adoption of certain organisational practices from the other organisation (Szulanski, 1996; Kostova, 1999). The difficulties are in part due to communication problems. Lack of language proficiency may severely hamper communication, but also, in situations when most of the persons interacting are fluent in a common language, there may be communication barriers in terms of different interpretations of explicit and implicit messages (Vaara, 2003; Javidan et al., 2005). Given the propensity of managers and firms to avoid uncertain projects (Cyert and March, 1992), the units are less likely to initiate processes of capability transfer when there are significant national cultural differences between the parties.

Third, even if employees in the receiving unit see the value in adopting certain organisational practices from the transferring unit, the costs involved in doing so are likely to be higher when they are located in culturally distant countries (Kostova, 1999). Differences in cognitive structures, in value systems and in behavioural norms all contribute to raising the costs involved in the capability transfer. Lack of foreign language proficiency among the people involved in the cross-border transfer of capabilities may also significantly raise capability transfer costs (Grant, 1996). As a

consequence, the parties are less likely to engage in processes of acquiring and assimilating capabilities.

Fourth, organisations located in culturally different countries are less likely to have a history of collaboration. To the extent that two units collaborate, they develop organisational routines for interacting with the other party over time. Individuals in the two units are also likely to develop cognitive structures that facilitate further absorption of knowledge, including tools and processes. Based on these arguments we suggest the following proposition:

Proposition 2: Greater cultural differences between the acquiring firm and the acquired firm will be associated with lower levels of potential absorptive capacity.

### **Social integration**

There is extensive evidence in social psychology that perceived similarity tends to result in a higher degree of attraction towards the other party (Byrne, 1971; Darr and Kurtzberg, 2000). Shared values, norms, and patterns of behaviour facilitate the creation of a shared identity and the emergence of trust, while at the same time limiting the potential for conflict in a relationship (Sitkin and Roth, 1993; Kramer, 1999; Lewicki and Wiethoff, 2000). In contrast, trust can erode and the potential for conflict increase when a party is perceived as not sharing key cultural values, because that party is perceived as operating under values and assumptions so different that the party's underlying world view becomes suspect (Sitkin and Roth, 1993). Because individuals are more likely to perceive out-group than in-group members as untrustworthy, trust in a person or group will be greater when the two are culturally or ethnically similar (McAllister, 1995). As a result of basic cognitive processes such as social categorisation, out-group members are often attributed negative characteristics and intentions (Kramer et al., 1996; Kramer, 1999), which may generate or reinforce feelings of suspicion, as the members of the outgroup are being evaluated 'as uniformly unethical or malevolent, incompetent, and ill-informed – and the in-group is viewed in the opposite terms' (Sitkin and Stickel, 1996: 212).

Similar processes can be observed in interorganisational relationships. Research on cooperative alliances between firms has shown that shared values facilitate the creation and maintenance of trust; conversely, value incongruence has been found to have a negative impact on trust and the quality of communication and collaboration between alliance partners (Anderson and Weitz, 1989; Sarkar et al., 1997). In mergers and acquisitions, cultural differences often lead to increased in-group out-group bias and ‘us vs them’ thinking, with a tendency for organizational members to exaggerate differences rather than try to find common ground (Elsass and Veiga, 1994; Marks and Mirvis, 1998; Stahl and Sitkin, 2005). Social identity theory (Tajfel, 1981; Turner, 1982) explains how, under conditions of perceived external threat such as in acquisitions, individuals strive to maintain their positive social identity by idealising their own group and denigrating the other group, with them becoming a more cohesive unit in response to the perceived external threat.

In the aftermath of an acquisition, fundamentally different values, goals and beliefs concerning appropriate organisational practices may lead to covert or overt political struggles between the two parties (Vaara, 2003). In cross-border acquisitions, such politicisation tends to be fuelled by cultural stereotypes, nationalism, and sometimes even xenophobia. The resulting rift often unites people on the same side of national boundaries, a tendency that is further strengthened when specific issues are discussed in the national media (Risberg et al., 2003). The actions taken and the messages sent by the acquiring organisation are particularly likely to be misinterpreted by employees in culturally distant countries, creating false impressions that in turn trigger political behaviour and conflicts (Vaara, 2003). Furthermore, there is reason to suspect that cultural differences, both national and organisational, become easy attribution targets, meaning that internal politics or power struggles are seen or portrayed as being caused by cultural differences, even in circumstances where this is not the case (Vaara, 2002). The foregoing discussion suggests the following proposition:

Proposition 3: Greater cultural differences between the acquiring firm and the acquired firm will be associated with lower levels of social integration.

Next, we will examine how characteristics of the acquirer–target relationship and the integration process may moderate the effects of cultural differences on social integration and target absorptive capacity.

### **The moderating roles of social integration mechanisms and operational integration**

While the pre-acquisition cultural differences are likely to be important antecedents of the social integration following the acquisition, a ‘process perspective’ on acquisition integration suggests that the extent to which projected synergies are realised depends largely on the ability of the acquirer to manage the integration process in an effective manner (Jemison and Sitkin, 1986; Haspeslagh and Jemison, 1991; Birkinshaw et al., 2000).

The importance of social (or informal) integration mechanisms – such as personnel rotation, short-term visits, participation in joint training programmes and meetings, and membership in cross-unit teams, task forces and committees – has been stressed in research both on control and coordination of the MNC in general (Edstrom and Galbraith, 1977; Doz and Prahalad, 1981; Bartlett and Ghoshal, 1989; Roth et al., 1991) and on acquisitions in particular (Haspeslagh and Jemison, 1991; Birkinshaw et al., 2000; Larsson and Lubatkin, 2001). Through the use of social integration mechanisms between headquarters and foreign subsidiaries as well as between subsidiaries, individuals are likely to develop open and positive attitudes towards other nationalities and cultures (Edstrom and Galbraith, 1977). In the context of acquisitions, the use of social integration mechanisms has been shown to lead to interunit trust and the development of shared vision, objectives and cultural values (Larsson and Lubatkin, 2001). As noted by Buono et al. (1985), ‘[s]ince subjective culture evolves over time as a product of shared experience, when attempting to merge two firms, the greater the number of these shared experiences the faster a repertoire of symbols and shared meanings will develop with which the merged group of members can begin to identify, and a new culture can begin to take hold’ (p: 498). Involvement of the acquired employees in discussions concerning the post-acquisition management and the quality of communication are also likely to influence interunit social integration (Kim and Mauborgne, 1998; Hubbard and Purcell, 2001). Therefore:

Proposition 4: Use of social integration mechanisms will moderate the relationship between cultural differences and social integration, such that extensive use of social integration mechanisms will reduce the negative effects of cultural differences on social integration.

Research on MNCs has shown that the use of social integration mechanisms tends to lead to the creation of interpersonal networks and more extensive communication across units (Ghoshal et al., 1994). The increase in interunit interaction is, in turn, likely to enhance the focal unit's ability to identify, acquire and assimilate capabilities residing in the other unit because it receives more information about the latter (Lenox and King, 2004). The focal unit is therefore likely to learn how to easier evaluate and acquire capabilities from the other party. In other words, the use of teams and task forces with members from the merging organisations, visits, joint training and development programmes and other specific social integration efforts are likely to affect the relationship between cultural differences and potential absorptive capacity.

Proposition 5: Use of social integration mechanisms will moderate the relationship between cultural differences and potential absorptive capacity, such that extensive use of social integration mechanisms will reduce the negative effects of cultural differences on potential absorptive capacity.

It has been argued that removal of autonomy may hamper the social integration process (Weber, 1996; Larsson and Lubatkin, 2001). Although, theoretically, integration can result in a balanced merging of two organisations, this balance rarely occurs in practice; instead, the acquirer typically imposes control on the target firm, and where changes occur in policies, systems and culture, they affect the target firm more strongly than the acquirer (Hambrick and Cannella, 1993; Pablo, 1994; Cartwright and Cooper, 1996). The acquiring firm may use a variety of formal integration mechanisms to impose

control upon the acquired organisation. For instance, the acquirer may require that a rigorous set of rules and systems be implemented in the acquired unit in order to gain quick control – a situation that Datta and Grant (1990: 32) have termed the ‘conquering army syndrome’. The acquired unit may also be forced to adopt structures, processes and practices from the acquiring company. Further, managers in the acquired unit may have to discuss and negotiate operational decisions that they previously had the authority to make by themselves. Such changes translate into a high degree of integration of the acquired unit with that of the acquirer.

Changes leading to a high degree of operational integration and control are often resisted by members of the acquired firm, because they signal a general disregard for the legitimacy of the acquired firm’s ways of doing things (Hambrick and Cannella, 1993; Very et al., 1997). Moreover, a high degree of integration into the operational system of the acquiring firm is likely to increase acculturative stress and lead to feelings of hostility, resentment and distrust on the part of the acquired firm members, and may thus impede the social integration process (Buono and Bowditch, 1989; Hambrick and Cannella, 1993; David and Singh, 1994). By contrast, in acquisitions that require lower levels of operational integration, acquired units are often granted a considerable degree of autonomy, and there is less extensive interaction among the members of the two firms, which reduces post-acquisition stress and the likelihood of culture-related problems (Slangen, 2006). As noted by Shenkar (2001: 527–528), ‘how different one culture is from another has little meaning until those cultures are brought into contact with one another.’ These arguments suggest the following proposition:

Proposition 6: Degree of operational integration will moderate the relationship between cultural differences and social integration, such that a high degree of operational integration will increase the negative effects of cultural differences on social integration.

While a high degree of operational integration is likely to amplify the negative impact of cultural differences on social integration, we propose that the effect will be the opposite on potential absorptive capacity. Common structures, processes and practices as well as integration of activities across the acquiring and acquired units will make it easier to identify, acquire and assimilate capabilities residing in the other unit (Cohen and Levinthal, 1990; Lane and Lubatkin, 1998). The creation of joint processes and practices provides easier access to codified knowledge in the merging organisations. Additionally, operational integration may facilitate the transfer and assimilation of more tacit knowledge, as processes and practices will have to be articulated and possibly also codified (Zollo and Winter, 2002). We therefore suggest that:

Proposition 7: Degree of operational integration will moderate the relationship between cultural differences and potential absorptive capacity, such that a high degree of operational integration will reduce the negative effects of cultural differences on potential absorptive capacity.

### **Factors influencing capability transfer**

A large body of research suggests that, in corporations characterised by high levels of social integration, employees in different organisational units are more likely to engage in behaviour that is compatible with the interests of the overall organisation. MNC scholars have argued that social integration is an important predictor of resourcesharing and transfer across units (e.g., Hedlund, 1986; Bartlett and Ghoshal, 1989; Nahapiet and Ghoshal, 1998; Kostova, 1999). Moreover, the level of social integration has been shown to be positively associated with interunit capability transfer. For instance, Szulanski (1996) identified the perceived reliability of the sending organisation as a determinant of knowledge transfer. Tsai and Ghoshal (1998) found that trust was a strong determinant of resource exchange and combination among units belonging to the same MNC, and Kostova and Roth (2002) found identification with the headquarters and trust to be positively associated with the adoption of MNC home country strategic organisational

practices by foreign subsidiaries. As Bresman et al. (1999: 442) noted in their study of knowledge transfer following international acquisitions, 'individuals will only participate willingly in knowledge exchange once they share a sense of identity or belonging with their colleagues.' The degree of social integration is likely to be particularly important in cases of complex transfers of capability combinations (cf. Buckley and Carter, 2004) and more crucial for the transfer of tacit than the transfer of explicit knowledge (Chaudhuri, 2005).

The accumulated evidence suggests the following proposition:

Proposition 8: High levels of social integration will be associated with higher levels of capability transfer between the acquiring and the acquired firm.

An acquired unit with a high potential absorptive capacity is by definition receptive to acquire and assimilate knowledge from the acquirer (Zahra and George, 2002). Although a high level of potential absorptive capacity does not automatically translate into successful interunit capability transfers, we expect the level of realised capability transfer to be higher in acquisitions that are characterised by a high level of potential absorptive capacity.

Proposition 9: High levels of potential absorptive capacity will be associated with higher levels of capability transfer between the acquiring and the acquired firm.

Prior research suggests that the existence of capability complementarities is positively associated with interunit capability transfer. The results of a case survey of 61 acquisitions conducted by Larsson and Finkelstein (1999) show that resource or capability complementarities, such as different products, market access or knowledge, that fit with and enhance one another, create opportunities for various synergistic outcomes, including transfer of current know-how and the creation of new knowhow. In a

study of horizontal acquisitions in Europe and North America, Capron et al. (1998) found that the relative strength of merging firms along several resource dimensions affected the redeployment of these resources in the other firm. Similar results have been obtained in studies of subsidiaries of MNCs in general (Holm and Pedersen, 2000). Therefore we propose that:

Proposition 10: High levels of interunit capability complementarity will be associated with higher levels of capability transfer between the acquiring and the acquired firm.

## **Discussion**

While the ‘dark side’ of cultural differences has been extensively discussed in the acquisition literature, the potential benefits of cultural differences in terms of increased potential for capability transfer have been largely neglected. Although M&A scholars have pointed to positive aspects of national cultural differences in acquisitions (e.g., Very et al., 1996; Larsson and Risberg, 1998; Morosini et al., 1998), they have paid relatively little attention to the mechanisms through which such differences may impact on capability transfers and, subsequently, post-acquisition performance. As a step towards developing a more elaborate understanding of the role of cultural differences in the post-acquisition integration process, this paper has focused on capability transfer, an important motive and objective in cross-border acquisitions. The model developed in this paper delineates the mechanisms through which cultural differences affect the transfer of capabilities and, thus, the post-acquisition performance. We propose that cultural differences can be both an asset and a liability, and explicate some of the key variables and processes through which we can understand these dual effects. In brief, cultural differences can be beneficial because they may enhance the combination potential. However, they can also create obstacles to reaping integration benefits by exacerbating social integration problems and diminishing the acquired and acquiring firms’ capacity to absorb capabilities from the other party.

For managers, the model developed in this paper points to mechanisms that enhance and hamper post-acquisition capability transfers. We suggest that the use of appropriate social integration mechanisms can enhance social integration and target absorptive capacity, and thus increase the extent of interunit capability transfer. Operational integration, although proposed to reduce the level of social integration, is likely to improve the capacity of the merging units to absorb capabilities from each other. Thus the execution of a well-designed integration process that enhances the organisation's capacity to acquire and assimilate new capabilities, while minimising interpersonal and intercultural friction, is critical to capturing synergies (e.g., Birkinshaw et al., 2000; Schweiger, 2002).

Our intention has been to develop a model of the key factors that mediate the effect of cultural differences between the acquiring and acquired firms on the extent to which capability transfer takes place from one to the other. We have incorporated two dynamic elements – the use of social integration mechanisms and the degree of operational integration – to overcome some of the limitations of previous theory-building efforts, which tended to take a rather static view of the cultural issues inherent in acquisitions and largely treated the integration process as a 'black box'. The model does not attempt to capture all variables and processes that affect the capability transfer, but we believe that it is comprehensive enough to explain a significant amount of variance in the post-acquisition capability transfer while being parsimonious. For researchers aspiring to build a more comprehensive model, we suggest the inclusion of variables such as acquisition experience (Haleblian and Finkelstein, 1999; Hayward, 2002; Uhlenbruck, 2004), industry context (David and Singh, 1994), the degree of dependence of the recipient unit on the sender (Kostova and Roth, 2002), the degree to which the focal capabilities include tacit elements embedded in non-formalised but routinised actions and interactions (Empson, 2001; Chaudhuri, 2005), and acquirer cultural tolerance and sensitivity (Nahavandi and Malekzadeh, 1988; Chatterjee et al., 1992) as potential moderators of the relationship between cultural differences and post-acquisition capability transfer. Scholars may also model factors that influence the post-acquisition performance in terms of accounting-based measures and/ or stock market price of the acquiring firm. Based on previous research on both acquisitions (Capron, 1999; Capron

and Pestre, 2002) and MNC units in general (e.g., Tsai and Ghoshal, 1998) a positive relationship between capability transfer and postacquisition financial performance is to be expected.

Another way to further develop the model presented in this paper is to incorporate more explicitly dynamic elements. Examples of capability transfers perceived by employees in the merging organisations as successful may have positive effects on the level of social integration in terms of closer interunit social relationships and increased trust. The interunit interaction necessary to transfer capabilities is also likely to augment the potential absorptive capacity of the acquired or acquiring unit through a convergence of cognitive structures and behavioural norms as well as the development of norms of interunit interaction and collaboration that may facilitate the transfer of capabilities. A likely result of past interunit capability transfers is improved knowledge of the potentially valuable capabilities residing in the other unit. A longitudinal research design is needed to conduct a proper test of the possible effects of such feedback loops.

One of the issues that scholars will need to address in further research is the question of level of analysis. One of the key issues is whether to use data on differences in values, beliefs and practices collected at the organisational level rather than using existing country-level data about differences in the national cultures between the organizations involved in the acquisition. As the merging units can be seen as specific organisational and suborganisational cultural configurations embedded in their particular contexts (national, industrial, etc.), it is in principle possible to use national-level cultural data such as the measures developed based on the research conducted by Hofstede (1980) and the GLOBE project (House et al., 2004). However, for research in this area to make further progress we encourage researchers studying the relationship between cultural differences and post-acquisition performance to focus on the specific configurations of beliefs, values and practices that exist between the units involved in the merger. This would also allow acquisition researchers to study the dynamic interplay between different dimensions of cultural differences in the post-acquisition process.

Furthermore, capability transfers often take place at a functional level, or even at the level of specific teams of employees. For instance, acquisitions of high-technology

companies may be carried out with the primary objective to integrate teams of researchers in the acquiring and acquired firms with the vision of sharing capabilities among the research teams (Chaudhuri and Tabrizi, 1999; Chaudhuri, 2005). In such cases, the variables and relationships in the proposed model, including cultural differences between the merging units, are most appropriately examined at the functional or business unit levels rather than at the firm level of analysis. When most of the capability transfer takes place within one function or business unit, the mediating factors are also likely to operate at this level of analysis.

We hope that the propositions developed in this paper provide a useful basis for future empirical investigations into factors that contribute to postacquisition performance. Such studies are needed to corroborate the hypothesised relationships as well as for developing our understanding of the various contextual variables that moderate their impact. The time is ripe to take additional steps towards opening the ‘black box’ of the performance implications of cultural differences in mergers and acquisitions.

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