

Effect of Cultural Differences on Performance of Merger and Acquisition via Psychological Safety: A Framework

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ABSTRACT

This article proposes a framework connecting cultural difference with performance of M & A via psychological safety of target firms' employees. Existing studies have suggested the need of effective social-cultural integration post acquisition for the success of M & A of culturally distant firms. This paper includes leadership visibility as the boundary condition of relationship between cultural difference and psychological safety of the employees of target firms. Existing literature indicates cultural difference between merging organization as one of the factors for the poor performance of M&A. Proposed framework elucidate, mechanism through which cultural difference between merging firm effects the performance of M & A. However there is extant literature investigating effect of cultural difference on performance but studies examining the mechanism of this effect is still in its infancy. This study contribute to the literature by investigating the mediating role of psychological safety and moderating role of leadership visibility.

Keywords: *Cultural Difference, Leadership, Visibility, Performance, Psychological Safety*

INTRODUCTION

A merger is the integration of two independent legal entities. Merged firms integrate to form a new organization for sharing resources and cooperate for common objectives (Horwitz et al., 2002). Acquisition refers to gaining control over or taking ownership of another company (Horwitz et al. 2002). We have used merger and acquisition interchangeably in our

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study since result is the same; one organization takes control of another (Waight, 2004).

Merger and acquisitions (M&As) have become the most prevalent option of growth for firms seeking competitive advantage in complex global business environment (Adler, 1997). But at the same time it is discouraging to notice that M&As are plagued by many problems (Newbury & Zeira, 1997), with failure rate of 50% in domestic acquisitions and 70% in cross-border acquisitions (Capron, 1999). Many scholars attempted to explore the reasons of failures in terms of strategic market entry choice (Hennart & Park, 1993), market valuations (Jensen & Ruback, 1983), value creation (Haspeslagh & Jemison, 1991) and firm performance (Blackburn & Lang, 1989). Least attention has been given to examine the higher failure rate of M&A in terms of human resources. Top executives or decision makers has focused on the strategic issues of M&A and completely ignored the human resources before, during and after M&A. Most commonly M&A are triggered by the growth strategy and synergy motive of the firm. Importance of human resources has been sidelined by decision makers as well as researchers.

Recently scholars have shifted their attention towards the role of human behaviour and organizational identity in post-merger integration and M&A performance (e.g., Bjorkman et al., 2007; DeNisi & Shin, 2004; Ulrich et al., 2005; Weber & Tarba, 2010). Number of scholars have used fit cultural concept to examine the pernicious relationship between premerger cultural differences and post -merger integration effectiveness (Bjorkman et al., 2007; Stahl & Voight, 2008). Mixed results have shown positive and negative effect on cultural compatibility on M&A performance. Veiga et al. (2000) asserted best performance can be achieved when premerger cultural incompatibility turns into cultural compatibility after merger. It is important to have cultural compatibility during integration process to explore the full potential of M&A. Some researchers have examined the cultural compatibility issue from the lens of social identity. Social identity refers to how members of an organization define themselves, considering their affiliation, profession, and /or organization itself (Ashforth & Mael, 1989). Individual, who identify with the organization possess strong sense of support for the values and norms that they consider important, distinctive, and enduring (Albert & Whetten, 1985). Organizational identity in M&A influences the attitude and behaviour of people following the merger (e.g., Ulrich et al., 2005; Van Dick et al., 2004; Weber, 1996).

Extant literature available examining the effect of cultural difference on post-acquisition performance, however, most of these studies are

inclusive in exploring this relationship (Stahl & Voigt, 2008). Among the various reasons of failure of M & A, one is cultural difference (national & organizational culture) between two merging firms. Although several studies have been conducted to examine the effect of cultural difference on the performance of M & A but there is paucity of research examining the mechanism and through which cultural difference effects the performance of M & A. This paper attempts to contribute to the existing scarce literature by investigating the effect of cultural difference on performance of M & A via psychological safety of target firms' employees. A framework is proposed based on extensive literature review, which explains the aforementioned relationship. Leadership of the acquirer has been considered as the key factor in socio-cultural integration of culturally distant firms after acquisition, hence proposed framework (Figure 1), portrays leadership visibility as moderator between cultural difference of merging firms and psychological safety of employees. M & A process brings lot of anxiety, fear, stress and uncertainty, that have potential to harm the psychological safety and hence performance of the employee especially in M & A of culturally different companies. Thus proposed framework attempts to exemplify the importance of leadership visibility on the psychological safety and performance of the M & A.

Preoccupied with financial and legal aspects of mergers, top executives, investment bankers and lawyers rarely consider the impact that these events have on the lifeblood of an organisation, the employees (Jemison & Sitkin, 1986a, b). Given the poor immunity of human resource for potential havoc arising from M & A, proactive behaviour from the executives managing merger and acquisition (M&A) is required to minimize the potential problems associated with this event. Employees in merged organization found their selves lost, and ponder questions like uncertainties about their future, job change, and change in work and family relationships (Lavinson, 1970; Gill & Foudler, 1978; Sinetar, 1981; Schweiger & Ivancevich, 1985). Lazarus and Folkman (1986) proposed three cognitive appraisalsthat people make of any event they face. They are (i) irrelevant (ii) benign-positive (iii) stressful. If merger is perceived as having no effect on job of existing employees, then it is referred as irrelevant. If merger is perceived as having positive effect on job of existing employees, then it is referred as benign-positive cognitive appraisal. Employees feel enhanced position on company after merger, and their self-esteem gets enhanced. Stressful cognitive appraisal leads to low self-esteem or sense of powerlessness. Employees feel threat to his job and perceive challenge in doing his/her job after merger. Employee feels

uncertainty regarding his job. Impact of merger depends upon the way it has been appraised cognitively by an employee. Ivancevich, Schweiger and Power (1987) found three factors created by merger event that triggers the stressful cognitive appraisal in an employee. These factors are uncertainty, duration and imminence. Uncertainty about the event and its consequences influence the stressful cognitive appraisal. Similarly, longer duration of this uncertainty or stressful period negatively impact the health of the employees. Imminence refers to time left before actual happening of event. If more time is left before the actual happening of an event then employee can think about new action plan to manage the consequence of the event but on the other hand imminent leads to intense and complex appraisal process. Depression, anxiety, anger, a lower self-esteem and low life satisfactions are some of stress responses (Schweiger & Ivancevich, 1985). These stress responses influence negatively the behaviour of employees. Negative behaviour stimulated by stressors is depression, turnover, poor performance, and tardiness (Schweiger & Ivancevich, 1985). Given the negative consequences of stressors associated with merger, it is inevitable to investigate the ways to manage human resources during merger and acquisition carefully so that organizations can prevent negative behavioural outcomes.

THEORETICAL FRAMEWORK AND DEVELOPMENT OF PROPOSITIONS

Cultural difference and performance of M & A

Aguilera and Dencker (2004) studied the impact of national culture on the cross-border merger and acquisition (M& A) and provided a framework that fits the M&A strategy with HRM strategy. Paper also highlights the roles of human resource in terms of resources, processes and values in integration of cross-border mergers. Cross-national factors influences the success of M&A. Since national contexts have been grouped along many dimensions, such as legal (La Porta et al. 1998), cultural (Hofstede, 1980), financial (Zysman, 1983), employment system (Marsden, 1999), economic organization and control (Whitley, 1999) or government regimes (Aguilera & Jackson, 2003). These factors influence the cross-border merger differently. Decision maker needs to take care of these factors before any cross-border merger decision. Cross-cultural managerial studies have shown that behaviours like individualism and openness to

foreign differ across national boundaries (Adler et al., 1986) and influence the cross-border M&A (Gersten et al., 1998).

Extant literature available examines the effect of cultural difference on post-acquisition performance, however, most of these studies are inclusive in exploring this relationship (Stahl & Voigt, 2008). One group of the existing studies found negative association between cultural distance and post-acquisition performance (Bunno et al., 1985). Another group of studies suggested positive impact of cultural distance on performance as diverse set of new routines and pool of skills enable acquirer to operate successfully in a new environment (Chakrabarti et al., 2009; Moronsini et al., 1998). Albeit cultural difference affects the performance of M & A but its effect is function of degree in which the acquirer seeks to integrate the acquired firm (Slangen, 2006). Low degree of integration results in to good post-acquisition performance unlike high degree of post-acquisition integration even in the presence of huge cultural difference (Slangen, 2006). Cross-cultural experience is another factor that influences its impact on post-acquisition performance. Experienced acquirers being aware of cultural difference evaluate the target more carefully, formulate better diligence plans and with improved skills, managed to reduce the friction emanating from cultural differences (Chakrabarti et al., 2009). On the other hand inexperienced acquirers are unable to understand the nuances of acquisition making process and end up ignoring the potential pitfalls in the cross-border acquisition process (Nadolska & Barema, 2007). Dikova and Sahib (2013) suggested that prior experience of the acquirer positively affects performance of M & A as experience helps them in resolving related conflicts effectively, which enable acquirer in gaining benefits from cultural differences. Therefore, cultural difference is not always detrimental for the performance of M&A but it depends up on other mediating factors like experience of acquirer, degree of integration etc., which can reduce its negative impact on performance. Several studies have argued the positive effect of cultural difference on the performance of M & A. These studies suggested cross-border acquisitions enable the acquirer to access the valuable assets embedded in other national cultures without developing them over time (Jemison & Sitkin, 1986). Acquirer gets many benefits such that access to valuable pool of critical routines and stick of skills not available to the firm earlier (Ghosal, 1987). However there are many benefits associated with the M & A of culturally distance firms, but it depends upon the effective integration of the culturally different firms. For instance, culturally different firms have different organizational practices (Child et al., 2001), different resolution strategies (Cushman et al., 1985),

different human resource practices (Schuler, 1998) and management styles (Ralston et al., 1993). As employees are strongly embedded in their own culture (Buono & Bowditch, 1989), thus it's very difficult to integrate the different organizational and national culture. These cultural differences give birth to misunderstandings and misattribution of motives and intentions that resists smooth interactions of people (Slangen, 2006). Lack of effective communication causes uncertainty, confusion, distress and hostility among the employees (Elsass & Veiga, 1994; Hofstede, 2001). People start behaving abnormally upon and feel acculturative stress as they are unable to interact with fellow-employee from different cultural (Very et al., 1996). Thus, cultural differences between the acquirer and target firms, pose greater challenge before acquirer, and increase cost of integration (Morosini et al., 1988), which leads to poor performance of culturally different firms. Recently, Hajro (2015) in his longitudinal study of merger between Australia and a Germany energy provider found that effect of national and organizational cultural differences on M & A outcome is mediated by socio-cultural integration process. Socio-cultural integration process defined in terms of the formation of interpersonal relationships, trust and shared identity. Marks and Mirvis (2011) suggested the four distinct states of cultural integration- pluralism (in which partner companies coexists), integration (in which partners blend current culture together), assimilation (in which one company absorbs the other), and transformation (in which the partner companies abandon key elements of their current cultures and adopt new values and norms). They suggested the integration of cultures can be made easy by managing these four stages carefully. Success or failure of the M & A of culturally different firms is function of social –cultural integration of the combined firms. Ahammad et al. (2014) found organizational culture difference mediates the relationship between knowledge transfer and cross-border acquisition success. They confirmed the negative association between cultural difference and M & A performance. But their findings indicated knowledge transfer and employee retention have positive effect on performance of M & A. Thus, it can be construed that cultural difference creates non-conducive environment for the knowledge transfer between combined firms which leads to poor performance of M & A. Therefore the effective socio-cultural integration is very important for the success of culturally different M & A. In absence of effective leadership, it becomes difficult to achieve social-cultural integration after acquisition, which leads to the poor performance of M & A. Merging the two culturally distant firms is very difficult wing to various reasons like resistance from

employees of both firms stemming from uncertainty, fear and anxiety; difference is working style, organizational practices, and management styles. Therefore, a negative relationship between cultural distance and performance of M & A, is expected, unless social-cultural integration is managed properly. Thus:

Proposition 1: Cultural difference will be negatively related to performance of the M & A.

Cultural Difference and Psychological Safety

Much ignored factor in early times that is human side factors have gained the attention of many researchers in recent times in M & A studies. Human side factors are crucial for the success or failure of any M & A (e.g., Cartwright & Cooper, 1993; Weber et al., 2012; Stahl et al., 2013). Recent studies have also explored the emotional state of employees during and after the M & A (Ager, 2011; Huy, 2012; Wilderom et al., 2011). The national culture of merging companies greatly influences the performance of post-acquisition (Rotting, 2013; Weber & Tarba, 2013), which creates different challenges for the targets' employees. There is paucity of research examining the role of human side factor in integration of culturally different companies (Gunkel et al., 2015). Leadership has the great potential to influence the relationship between cultural difference and its outcomes since leadership has ability to influence the perception of deal status (Zhang et al., 2015). During and after M & A employees feel very stressed, anxious, and psychologically insecure. Several studies have tried to explore the status and effect of employees' psychological safety during and after M & A. Recently, Rao-Nicholson et al. (2015) studied the impact of leadership on the employee psychological safety of target company employees. They found trust of target employees in leadership of multinational companies improves their psychological safety. Psychological safety refers to employees' views of the results of taking interpersonal risks in their work environment (Edmondson et al., 2004). Psychologically safe employees feel free in taking their decisions at workplace without any fear to job security, negative spill overs on image, career and status. Leadership plays a vital role in shaping the perception of employees of M & A which further influences the post-acquisition performance (Nemanich & Keller, 2007; Vasilaki, 2011). Leadership creates conducive environment for psychological conditions, which help employees in doing their jobs and it has positive relationship with psychological safety of the employees (Carmeli et al., 2014; Rao-

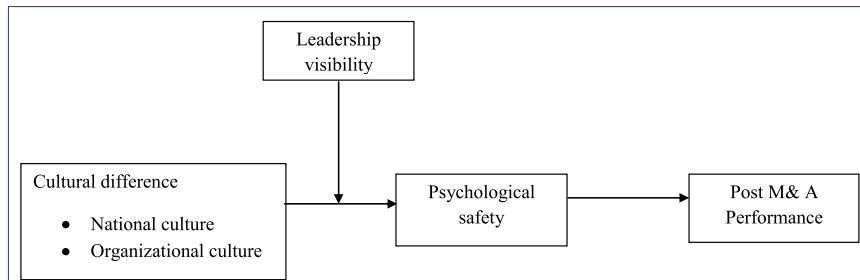
Nicholson et al., 2015). M & A process creates uncertainty in work environment and employees in lieu of related information especially related to their tenure and future, start feeling psychologically unsafe (Carmeli et al., 2014; Edmondson et al., 2004). This feeling of psychological unsafety leads to many negative consequences for the organization.

Culturally different firms have different organizational practices (Child et al., 2001), different resolution strategies (Cushman et al., 1985), different human resource practices (Schuler, 1998) and management styles (Ralston et al., 1993). As employees are strongly embedded in their own culture (Buono & Bowditch, 1989), thus it's very difficult to integrate the different organizational and national culture. These cultural differences give birth to misunderstandings and misattribution of motives and intentions that resists smooth interactions of people (Slangen, 2006). Lack of effective communication causes uncertainty, confusion, distress and hostility among the employees (Elsass & Veiga, 1994; Hofstede, 2001). People start behaving abnormally upon and feel acculturative stress as they are unable to interact with fellow-employee from different cultural (Very et al., 1996).

Cultural difference creates very uncertain environment around target firms' employee, thus, they feel insecure, stressed, emotionally exhausted and fearful. Their main concern is job security. In culturally different acquisitions employees of target firm feels less motivate to participate into M & A activity as they find it difficult to express their views and take decisions freely. This leads to their disengagement from the M & A activity, which hampers the social integration process after M & A and finally poor post-acquisition performance. Therefore, negative relationship between cultural difference and psychological safety of employees in target firm is expected. Higher the cultural distance between two firms, lower will be the psychological safety felt by employees of target firms. Thus:

Proposition 2: Cultural difference between two firms will be negatively related to the psychological safety of target firms' employees.

Figure 1: Impact of Cultural Difference on M & A Performance via Perception of Psychological Safety of the Employee



Psychological Safety and Performance of M & A

Cultural difference (Marks & Mirvis, 1998) found to have negative behavioural consequences like stress and tension during M&A (Cartwright & Cooper, 1993). Top management's commitment and cooperation is negatively influenced by cultural difference (Weber et al., 1996). Existing studies in the field of organizational behaviour have indicated that low level of commitment leads to high rates of voluntary turnover (Mathieu & Zajac, 1990).

Weber and Drori (2011) asserted in addition to cultural clash, organizational identification with merger has a direct effect on acquired management attitude and behaviours that influences post-merger success. Identity reflects the central, distinctive, and enduring characteristic of an organization, especially through the articulation of a shared ethos and values that differentiates one organization from another (Albert & Whetten, 1985). Identity can be understood at three levels organization, professional, social and individual. Social identity emerges from individual's membership of a social group or groups along with value and emotional attached to that membership (Tajfel, 1978, 63). M&A members of different pre-merger organizations may work cooperatively within merger organization, when they are able to maintain their former allegiances and identity or are legitimated by dominant partner in a way that welcomes them in adopting the new identity (Dutton et al., 1994; Elsbach, 1999; Pratt, 1998). When the members are not allowed to continue their premerger identity then they feel threat, resistance, dismay, alienation, intergroup bias, hostility, or apathy toward the other organization (Terry & Callan, 1998). Some studies have pointed out employees who strongly identify with the merger, job satisfaction and citizen behaviour are comparable high and turnover and negative emotions remain relatively low (Van Dick et al., 2004; Van Dick et al., 2006).

Top managements' embraced values and beliefs drive the psychological safety within the organization. (Hall, Dollard, & Coward, 2010). Culture influences these values system and hence drive the psychological safety within the organization. For instance, Chinese managerial culture is based on Confucian values and paternalistic leadership (Walumbwa et al., 2004). Relationship between subordinate and supervisor is inherently different in the collective and hierarchical system (Hofstede, 1984). Therefore, cultural difference has potential to effect the psychological safety of the employees. Integration of employees of two different culture is very tedious job. If not handled effectively, can lead to reduced psychological safety of employees, which can affect the performance of M & A negatively. Work

culture varies from country to country. Without having knowledge of national and organizational culture of target firm, it will not be successful deal. Psychological safety of target firm's employee, comes in the way for social-cultural integration shaped by values and belief other than acquirer Company. Work environment where employees of target firm can express their view freely and they can take decisions independently feel psychologically safe. Psychological safe employees engage themselves in social-cultural integration, which leads to good performance of M & A. Therefore, psychological safety is positively related to the performance of M & A. This argument along with proposition 2, suggests psychological safety as mediator between cultural difference and performance of M & A. Thus:

Proposition 3: Psychological safety mediates the relationship between cultural difference and performance of the M & A.

MODERATING ROLE OF LEADERSHIP VISIBILITY

Leadership Visibility and Psychological Safety:

Post-acquisition period is characterized by employees' stress, high turnover and emotional cost that top leadership of acquiring company can effectively mitigate by encouraging involvement of target firms' employees (Stahl, Larsson, Kremershof, & Sitkin, 2011). The leaders of acquirer companies can align the disperse goals of individuals towards common goals and have ability to make effective transition from two independent organizations to one single entity through streamlined processes (Appelbaum, Lefrancois, Tonna, & Shapiro, 2007). The leadership styles influence the trust level of target firm employees in the acquirer organization (Rottig, 2013; Stahl, Chua, & Pablo, 2012) and it has many positive consequences for the organization such that retention and development of talent after M & A. Different national context demands different leadership style for achieving aforementioned goals. For instance, leaders of Chinese companies demonstrate nurturing and paternalistic leadership towards employees of their target firm (Zhang et al., 2015), and help in improving the employees' psychological safety after acquisition. Leadership boost the trust among target employees influence their engagement in post-M & A integration and positively effects their psychological safety. The trust in leadership's ability, integrity, reputation to deliver and value congruence between the acquirer's and targets' managerial structure can all positively

impact the employee psychological safety (Rottig, 2013). Therefore it can be construed that leadership of acquirer firm influences the psychological safety and hence their participation in integration process which positively effects the success of M & A. The leadership is very crucial for the social-cultural integration of two culturally distant firms that has potential to influence the performance of M & A.

Wickramasinghe and Karunaratne (2009) in their study on two different kinds of mergers of banks in Sri Lanka found employee's perception about merger changes with type of merger and age, gender and marital status influences the perception of employee. In the absence of actual information related to the M&A, an individual appraise the event based on his/her speculations so perception about the event and its consequences deemed to be an important part of employees lives (Marks, 2006). Information sharing plays an important role in perception formation of an individual concerning M&A and its consequences. Plethora of research has been conducted exploring the effect of communication in M&A process. Frequent and factual communication to employees stabilizes the negative effect of M&A on employee's perception (Schweiger & DeNisi, 1991; Marks & Mirvis, 1997). Proactive leadership of acquirer can here play a vital lot by providing relevant and correct information to the concerned employees. This will increase the trust of the employees and motivate them to engage in the socio-cultural integration after M & A.

The leadership visibility through effective engagement of the top management in the acquisition process, testimony the legitimacy of acquirer in the minds of the target employee's (Rottig, 2013). Communication from leaders and their engagement with local stakeholders influence the perception of target firm employees positively for M & A activity and help resolve any issues. The leadership visibility creates trustful, fearless and psychologically safe environment that improves the psychological safety of the employees in target firms. Rao-Nicholson et al. (2015) studied the impact of leadership on the employee psychological safety of target company employees. They found trust of target employees in leadership of multinational companies improves their psychological safety and environment. Employees feeling, psychologically safe put their efforts to mitigate the cultural gap, which results in to post-acquisition success. They are more engaged in activities initiated by top management to eliminate the cultural difference and hence contributes to M & A success. Prior studies have confirmed the positive effect of open communication used by leaders on post-acquisition credibility and employee retention within target companies (Zhang et al., 2015). Therefore, leadership visibility can

boost the trust of target firm employees in M & A process that leads to their psychological safety. A positive relationship between leadership visibility and psychological safety of target firm's employees is expected. Thus:

Proposition 4: Leadership visibility will be positively related to psychological safety of target firm's employees.

From proposition 2 and 4, I expect leadership visibility as moderator between cultural difference and psychological safety of employees of target firms. Thus:

Proposition 5: Leadership visibility of acquirer firm will moderate the relationship between cultural difference and psychological safety such that high (presence of) leadership visibility will reduce the negative effect of cultural difference on psychological safety of employees and low (absence of) leadership visibility will strengthen the negative effect of cultural difference on psychological safety of the employees of target firms.

DISCUSSION

This study presents a framework developed after extensive literature review on cultural difference and its impact on performance of M & A. Proposed framework (figure 1) includes the leadership visibility as moderator and psychological safety as mediator between cultural difference and performance of M & A. Author proposes the leadership visibility as moderator between cultural difference and psychological safety of target firm employees. There is paucity of research examining the mechanism through which cultural difference effects performance of M & A. This paper attempts to address that lacuna by proposing the framework examining the effect of cultural difference on post- performance. Given high failure rate of M&A alarmed the researchers for examining the poor performance of M&A through the effective leadership.

Cultural difference between two merging organizations and perception of employees concerning M&A formed based on their speculation are two major factor discussed in existing literature. Every employee perceives M&A differently depending upon their cognitive appraisal. That cognitive appraisal is influenced by information available. Literature indicated most of time employers do not share the relevant and required information with employees which leads to wrong perception by employees. These wrong perceptions are detrimental to the performance of M&A. Leadership visibility can shape the perception of the employees, that leads to felt psychological safety and hence positive attitude. Psychologically safe

employees get involved in to socio-cultural integration and help the organization in achieving the predefined goals of M & A. Leadership visibility has potential to influence the psychological safety of target employees by involving them in during and post M & A process. By providing all related information about M & A, they can be made psychologically safe, which leads to success of M & A. M & A of culturally distant firms can contribute towards the growth and success of the merging firms by making available the diverse set of skills, resources etc. but if, it is not managed properly then it can be disastrous. Therefore this paper has not only contributed to the existing literature on cultural integration and also has significant implications for practice.

As M&A has been widely employed option for growth by firms so studying the factors responsible for the performance of M&A is very germane. I have presented a framework that can be employed by firms in understanding the various performance issues arising out of poor leadership and cultural clashes.

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