Bounded Rationality: Effect on International M&A Performance of MNEs

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From a transaction cost economics perspective, this study builds a model to explain how the bounded rationality suggested by transaction cost economics affects the cross-cultural management capability, which in turn influences multinational enterprises' (MNEs) performance of international Mergers and Acquisitions (M&A). We explain the moderating effects of cultural distance, cultural intelligence and global mindset in the relationship between bounded rationality and MNEs' performance, and argue that cultural distance has a negative impacts on MNEs' post M&A performance and cultural intelligence and global mindset are positively associated with the cognitive capability of managers to deal with cross-cultural issues.

INTRODUCTION

Today it is commonly accepted that an important competitive advantage of MNEs is their superior ability to transfer and combine capabilities across geographically dispersed units.

In the past 30 years, M&A, especially the cross-border M&A, had been more and more popular in corporate development. Here we define cross-border M&A as those involving an acquirer firm and a target firm whose headquarters are located in different home countries. Technological development and globalization have deeply contributed to the popularity of M&As and cross-border M&As. Gross-border M&A activities have continued to increase at a torrid pace during the past a few decades, to the point that it has become a major strategic tool for growth of multinational corporations. 2015 has been a record year for M&As. Globally, M&A activities reached a volume of $4.9 trillion, beating the record of $4.6 trillion set in 2007, according to statistics from Dealogic. This can be

attributed to the dynamic nature of international trade. The consolidations of industries and regions have also contributed to the overall number and value of M&A worldwide to continuously increase.

Cross border M&As are an implementation instrument for the firm's international diversification strategy (internationalization) and have been motivated by the necessary search for new opportunities across different geographic locations and markets in a turbulent and continuously changing environment. Given the increasing number of cross-border M&As and their growing importance in the global market, a better understanding of the factors that affect the performance of cross-board M&A is meaningful.

THEORERICAL FOUNDATION

Transaction Cost Economics And Bounded Rationality

Origins. H.A. Simon created the beginnings of a theory of bounded rationality. He described decision making as a search process guided by aspiration levels. An aspiration level is a value of a goal variable which must be reached or surpassed by a satisfactory decision alternative. In the context of the theory of the firm one may think of goal variables like profit and market share.

Decision alternatives are not given but found one after the other in a search process. In the simplest case the search process goes on until a satisfactory alternative is found which reaches or surpasses the aspiration levels on the goal variables and then this alternative is taken. Simon coined the word satisficing for this process.

Often satisficing is seen as the essence of Simon's approach. However, there is more to it than just satisficing. Aspiration levels are not fixed once and for all, but dynamically adjusted to the situation. They are raised, if it is easy to find satisfactory alternatives and lowered if satisfactory alternatives are hard to come by. This adaptation of aspiration levels is a central idea in Simon's early writings on bounded rationality.

Three features characterize Simon's original view of bounded rationality: Search for alternatives, satisficing, and aspiration adaptation. This is the how rationality comes out.

Bounds of rationality. Full rationality requires unlimited cognitive capabilities. Fully rational man is a mythical hero who knows the solutions of all mathematical problems and can immediately perform all computations, regardless of how difficult they are. Human beings are very different. Their cognitive capabilities are quite limited. For this reason alone the decision behavior of human beings cannot conform to the ideal of full rationality.

It could be the case that in spite of obvious cognitive limitations the behavior of human beings is approximately correctly described by the theory of full rationality. Confidence in this conjecture of approximate validity explains the tenacity with which many economists stick to the assumption of Bayesian maximization of subjectively expected utility. However, there is overwhelming experimental evidence for substantial deviations from Bayesian rationality. People do not obey Bayes' rule. Their probability judgments fail to satisfy basic requirements like monotonicity with respect to set inclusion, and they do not have consistent preferences, even in situations involving no risk and uncertainty.

The cognitive bounds of rationality are not the only ones. A decision maker may think that a choice is the only rational one, e.g. to stop smoking, but nevertheless not take it. Conclusions reached by rational deliberations may be overridden by strong emotional impulses. The lack of complete control over behavior is not due to motivational bounds of behavior rather than to cognitive ones. In a word, "bounds" are limitations and show the directions for analyzing M&A performance.

Organizational Management Theory.

In the organization management theory, bounded rationality is a way to represent how real managers make decisions in real organizations. It is the rationality that takes into account the limitations of the decision maker in terms of information, cognitive capacity, and attention as opposed to substantive rationality, which is not limited to satisficing, but rather aims at fully optimized solutions. Therefore, in organization management theory, "bounds" here are explicitly defined.

Transaction Cost Economics Theory

Origins. Transaction cost economics was originally introduced by Coase (1937) who tried to explain the existence of firms. Williamson (1975; 1985) then developed the idea further and elaborated the dependency of firms on outside partners - the term "partners" here comprises the business relationship between service supplier and client - leading to disadvantages due to transaction costs, opportunism and uncertainty. Transaction costs can be looked at from a macro and from a micro level (Noteboom 1992). The interactions between organizations or between different actors in organizations are governed by implicit rules, norms or values that are developed and exchanged (Ouchi 1980). From a macro

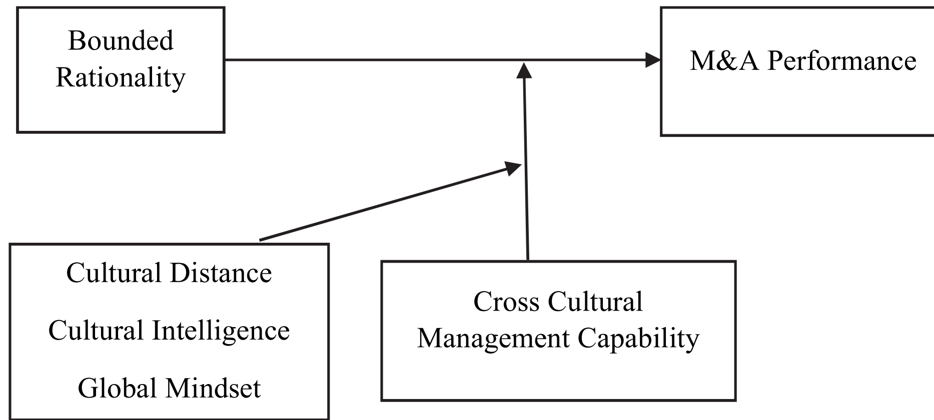
perspective, transaction costs evolve due to institutional arrangements and bilateral interaction between organizations. Such arrangements have to be made so that a single institution does not have to specialize at a very high degree, which would in turn result in soaring internal transaction costs (North 1990). The rules and norms that govern institutional interactions are based on individual interaction patterns. Thus on a more micro level, frequently repeated activities result in habitualization, a quasi-substitute for institutional rules or norms. Habitualization provides psychological relief with which cognitive capacity of the individual can be economized. An individual's interaction patterns cause less transaction costs if they are governed by habitualization (Berger & Luckmann 1966) because it replaces external coordination mechanisms. That is the reason why scripts are of such high significance: they represent a type of habitualization but they focus on the process characteristics which are particularly important in terms of the service production and delivery process. Scripts in contrast to other forms of simple habitualization comprise not only the role of the acting individual but also other aspects that are relevant in relation to interaction patterns and the performance of the service transaction. We can see transaction-cost economics is an interdisciplinary undertaking that joins economics with aspects of organization theory.

Transaction Cost Economics focuses on the organization of transactions that occur whenever a good or service is transferred from a provider to a user across a technologically separable interface. When transactions occur within an organization, the transaction costs can include managing and monitoring personnel and procuring inputs and capital equipment. The transaction costs of buying the same good or service from an external provider can include the costs of source selection, contract management, performance measurement, and dispute resolution. Thus, the organization of transactions, or "governance structure," affects transaction costs. It can be considered as the basic theoretical framework that analyzes the relation between the service provider and the customer process; thus, the theory embeds and governs both sides of the process. Therefore, with reference to the efficiency aspect of the service, the transaction cost theory not only represents the link between those two processes but it also offers an explanation of why they have to be understood as a comprehensive process entity. In economics, bounded theory is the source of transaction cost economics.

HYPOTHESES DEVELOPMENT

Following the logic, this study develops a model to explain the relationship between bounded rationality and the M&A performance. Figure 1 shows the conceptual framework of this study, which is a moderated moderation model. The model shows that the culture-related factors including cultural distance, cultural intelligence, and global mindset moderated the impacts of cross-cultural management capabilities on the relationship between bounded rationality and M&A performance.

FIGURE 1
THE CONCEPTUAL MODEL



According to the bounded rationality theory, cross cultural management capability has some "bounds" (limitations). Here we collect the bounds as the factors to affect the cross cultural management capability including cultural distance, cultural intelligence and global mindset. We will analyze the details of these bounds later.

Proposition 1: Cross-cultural management capability moderates the relationship between bounded rationality on M&A performance.

For cross-board M&A, because it relates to different nations and culture, how to deal with cultural diversification is significant. Cross cultural management capability involves the capabilities managing work teams in ways that considers the differences in cultures, practices and preferences of consumers in a global or international business context. Managers possess cross cultural management capability ensures effective communication, and the three bounds we listed will affect the cross-board M&A performance. To be specific, a manager with cross cultural capability will apply their cross-cultural knowledge skillfully to develop context-specific actions that lead to organizational effectiveness.

From a global perspective to obtain information about the world, use the information experimentally, and also apply it in a complex environment. The role of cross-cultural management capability has three categories: first, bridging differences in a meaningful way, by actively managing differences between people, values and cultures. These differences are bridged when a conflict in values can nonetheless lead to productive cooperation and action. Second, leveraging differences and synergies integrates the disparate elements in an increasingly complex world. And third, managerial capability plays a coordinating role, more than a controlling one, because managers spend most of their time and resources in improving coordination and cooperation between the various elements of the worldwide system.

The cross-board M&A process is a process of transferring the property rights between the acquirer firm and target firm. Both sides have to pay transaction costs. We have to consider some kinds of costs incurred in the M&A process, such as costs for preparing, costs for negotiation and contracting, costs for transfer property right, costs for framework developing, costs for situation analysis, and costs for integration designing and implementing. During M&A process, transaction costs can be measured and analyzed for choosing merger target, designing M&A mode and contract, lower costs and higher success rate. How to deal with these kinds of transaction costs provides a framework for understanding and strategic implications to the cross-board M&A performance.

Culture, in general, is the homogeneity of characteristics that separates one human group from another. Culture provides a society's characteristic profile with respect to norms, values, and institutions that affords understanding of how societies manage exchanges. At the national level, culture is an

aggregate of individual values. As personal experiences and shared societal values shape the views of individuals equally, there might be variation in their value priorities. The concept of culture at the national level attempts to capture the typical individual value priorities in a society, which reflect the central thrust of their shared enculturation. Differences in national culture systems or the relative cultural distance between countries have been an important concern in the study of MNE strategies and organizational characteristics.

Cross-border business transactions involve interaction with different societal value systems. Although national boundaries do not always correspond with homogeneous value systems, there are strong forces within nations to create and maintain a shared culture. Adapting to local cultural values that are transmitted through nations' political economy, education, religion, and language may create an additional burden for MNE operating in different countries.

In the organization level, multinational corporations may need to possess a diverse set of routines and repertoires if they are to compete in a diverse world. Routines and repertoires are often dependent on the multinational corporation's unique institutional and cultural environment, and are therefore not imitated easily by other firms.

In the context of a cross-border M&A, national cultural distance represents distance in the norms, routines and repertoires for organizational design, new product development, and other aspects of management that are found in the acquirer's and the target's countries of origin. National cultural distance between countries has also been associated with significant differences in their legal systems, incentive routines, administrative practices and working styles. As multinational companies increasingly acquire targets in more culturally distant countries, they face new challenges in managing their external environment. In an uncertain environment, it is difficult for managers to know what routines and repertoires will provide sustainable competitive advantage and performance over time. Given the difficulty of forecasting valuable future routines and repertoires, it may be in a multinational firm's best interest to access a relatively large and diverse pool of routines and repertoires, thus increasing the probability that it will possess those that prove to be valuable in the future. What's more, the impact of national culture can result in the nationalistic bias of organizational members. These are some barriers of national cultural distance on cross border M&A performance.

Proposition 2: Cultural distance negatively moderates the impacts of cross-cultural management capabilities.

The definition of "intelligence" is culture bound. In the West, it is seen as linked to the speed of making correct judgments. In many African cultures, it is linked to the person's behavior conforming to the desires of the elders. Behavior that is considered intelligent in the West is seen as typical of people who are "crazy" by some Native American tribes.

With rapid advances in transportation and information technologies, firms are coming into greater intercultural contact than ever before. Intercultural contact is necessary and unavoidable in international business ventures such as offshore outsourcing. Firms with capabilities to manage intercultural contact (i.e., culturally intelligent firms) will outperform firms that are "less intelligent."

Cultural intelligence, defined as an individual's capability to function and manage effectively in culturally diverse settings, is consistent with Schmidt and Hunter's definition of general intelligence as "the ability to grasp and reason correctly with abstractions (concepts) and solve problems." Although early research tended to view intelligence narrowly as the ability to solve problems in academic settings, there is now increasing consensus that intelligence may be displayed in places other than the classroom. This growing interest in "real world" intelligence includes intelligence that focuses on specific content domains such as social intelligence, emotional intelligence and practical intelligence.

Cultural intelligence acknowledges the practical realities of globalization and focuses on a specific domain – intercultural settings. Thus, following Schmidt and Hunter's definition of general intelligence, cultural intelligence is a specific form of intelligence focused on capabilities to grasp, reason and behave effectively in situations characterized by cultural diversity.

The better a firm is at learning and generating new knowledge, the more intelligent the firm. Huber

defined organizational intelligence as an organization's capabilities to acquire, process, and interpret information external to the organization and is an input to the organization's decision makers. Although all organizational decision making involves some aspects of intelligence, Leidner and Elam distinguished organizational intelligence from organizational decision making. Intelligence is viewed as an input to the organization's decision makers. Thus, better intelligence should lead to better decisions and promote the performance of cross-board M&A performance.

Proposition 3: A higher level of cultural intelligence increases the cross-cultural management capability of MNEs to operate in international M&A context.

In our globalizing and interconnected world, more and more executives need to perform "global work." Global work can be defined as interacting across different cultures and markets, and it can be done either virtually or in person. This entails dealing with complexity as the context changes on several levels – e.g. environment, stakeholders – and at varying speeds, not to mention the interdependence or ambiguity that exists when operating in different locations.

In this background, managers need global mindset. Global mindset means the ability to influence individuals, groups, organizations, and systems that have different intellectual, social, and psychological knowledge or intelligence from your own. But, more than the old adage, "think globally and act locally," it's now "think and act both globally and locally" at the same time. This means not only recognize when it is beneficial to create a consistent global standard, but also deepen the understanding of local and cultural differences, crossing cultures and changing contexts. It requires simultaneously recognizing situations in which demands from both global and local elements are compelling, while combining an openness to and awareness of diversity across cultures and markets with a willingness and ability to synthesize across this diversity. A firm's management with global mindset has some features such as focus on big picture and changes in the corporation's environment, strong confidence in vision and organizational processes, high value of multicultural teams, diversity seen as a source of opportunities, constantly challenging own experiences and assumptions and open to change.

A manager with a global mindset is able to effectively lead across borders, serving a multitude of diverse shareholders in an ever-changing, uncertain, complex and ambiguous environment. A global mindset helps the manager to innovate in foreign cultures, become an early mover in the global marketplace, coordinate across different subsidiaries and regions, and understand trade-offs between global standardization and local customization. Therefore, managers with global mindset are indispensable in cross-board M&A process.

Proposition 4: A higher level of Global mindset increases the cross-cultural management capability of MNEs to operate in international M&A context.

CONCLUSION

The model presented in the article assumes that the M&A is a cross-board M&A, which the managers confront the problems of the cultural diversification. Therefore, in order to get better cross-board M&A performance, the management have to grasp the cross cultural capability and concern for the transaction costs during the process of cross-board M&A.

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