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Intercultural Financial Decision Making – A comparison between the financing of Pan European companies

Extended Abstract

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Abstract

Different finance theories have tried to explain the capital structure of companies. Although they have taken various factors into account, culture, and religion, haven't been part of this research. This research aims to fill this gap and looks into the linkage of cultural values and religious variables to explain why companies, in certain pan European countries, rather issue equity and in other one's preferer liabilities. The underlying Christian faith also plays a significant role in the capital structure. We hypothesize that companies in countries with a mainly Catholic faith preferably carry higher amounts of debt, and contrary firms in predominantly Protestant nations are more willing to issue equity.

1 Introduction

Companies typically will always be interested in a sustainably optimizing of their capital costs (Spiecker-Lampe, 2018). Looking at the general level of financing, companies have the decision between equity and debt capital, including the differences in liability, profit share, property claims, availability, tax burden, funding capacity, and risk (Perridon, Steiner, & Rathgeber, 2017). The influence of these decisions has been researched in different finance theories. However, soft facts and their impact, such as cultural and religious values, are not part of them. Therefore, this research aims to capture these connections by testing, on the one hand, the cultural values of nations and on the other hand the different underlying religious values, to explore the direct effect each one has on the manager and the indirect impact on the financial decision making to answer the following question:

To what extent does Culture and Religion matter for the capital structure of companies, and is there a difference in them?

2 Literature Review

Different finance theories look at the capital structure of firms. Firstly, the Modigliani-Miller-Theorem states, in a perfect market without transaction costs, bankruptcy costs, taxes, and the asymmetry of information, in three Propositions that the capital structure of a company doesn't affect the value of the company (Modigliani & Miller, 1958). Secondly, the trade-off-theory states that firms will choose their debt-equity ratio according to their maximum advantage, including minimum costs, with the main aim of using the tax shield (Kraus & Litzenberger, 1973). Thirdly, the pecking-order-theory, first introduced and mentioned by Donaldson (1961) and later on refined by Myers and Majluf (1984), which explains that financing sources will be chosen by way of the least resistance, which means at first internal financing and afterward debt capital. Fourthly, the market-time-theory holds the view that the current capital structure of firms is strongly related to the historical market value and firms don't care about financing their assets with debt or equity (Baker & Wurgler, 2002). All four theories display different criteria for choosing equity or liabilities. However, soft facts and their influence, such as cultural, religious values are not part of them.

One of these essential management theories is the Upper Echelons Theory from Hambrick & Mason (1984). It states that the organization reflects its top managers and their roots. Therefore, other researchers added to the UET the Institutional theory by North (1990) for a linkage between the individual, organizational, and institutional level (Nielsen & Nielsen, 2013). Overall, the literature finds an interrelation of culture to the manager and their decisions (Verduch Arosa, Richie, & Schumann, 2014) as well as their belief (Hambrick, Geletkanycz, & Fredrickson, 1993) and values with of their religion (Finkelstein & Hambrick, 1996).

Smith (1776) was the first one who connected financial decision making with culture. Hofestede and Bond (1988) describe culture as the way people think, feel, and act, including values, beliefs, behaviors, education, manners, and arts. Licht (2001) argues that culture is the ''mother of all path dependencies," and Maridal (2013) defines culture as "society's beliefs and value system." Nowadays, four major and mainly used cultural models have been stated.

Firstly, Hofstede's (1984) cultural dimensions, which include, amongst others, uncertainty avoidance, collectivism versus individualism, and long-term orientation. Secondly, Schwartz (1999) generated cultural dimensions as value types. Thirdly, the GLOBE Foundation forms nine dimensions, including institutional collectivism, in-group collectivism, future orientation, and uncertainty avoidance, among others (Dastmalchian, 2018). Fourthly, the World Value Survey, explain people's general values, beliefs, religion, environment, family, politics, etc. (Haerpfer, 2018).

The latest literature presents mainly three cultural variables which seem to have an essential influence on financial decision making. First, individualism pertains to societies where there are loose ties between individuals, in contrast to collectivism where people have a healthy relationship and behave cohesively (Haq, Hu, Faff, & Pathan, 2017). Mourouzidou-Damtsa, Milidonis, & Stathopoulos (2017) find evidence of a positive association between individualism and bank risk-taking. Second, uncertainty-avoidance which is negatively related to risk-taking. Commonly scientific research has shown that bank-risk-taking is negatively associated with a high uncertainty-avoidance (Ashraf, Zheng, & Arshad, 2016). Third, long-term orientation is mainly based on “Confucian thinking,” which implies to have long-term success (Hofstede, 2001). In general firms in countries with high long-term orientation tend to have less leverage (Wang & Esqueda, 2014).

Max Weber (1905) was one of the first who stated that religion has a significant influence on individuals and their economic behavior. Since then this connection has been tested in different studies and on different levels, such as the influence of religion on the individual, the influence of religion on organizations, and the influence of religion on institutions. Guiso, Sapienza, and Zingales (2003), for example, find that people with religious beliefs are associated with “good” economic attitudes, Hilary and Hui (2009) present that firms which are located in countries with a higher level of religiosity display a lower degree of risk exposure. Baxamusa and Jalal (2014) display that Protestant religiosity in a country leads to lower leverage and Diez-Esteban, Farinha, & Garcia-Gomez (2018) find results which indicate that companies from Protestant nations tend to take less risk, compared to Catholic ones.

3 Hypothesis

In conclusion, we hypothesize:

Hypothesis 1: Companies in predominantly Protestant countries issue more equity.

Hypothesis 2: Companies in predominant Catholic companies have more liabilities.

Hypothesis 3: A high level of individualism is linked to a higher level of equity within companies.

Hypothesis 4: A high level of collectivism is linked with a higher level of debt within companies.

Hypothesis 5: Protestantism is interrelated with a low level of uncertainty avoidance, and a low level of firm’s risk-taking.

Hypothesis 6: Catholicism is interrelated with a high level of uncertainty avoidance, and a high level of firm’s risk-taking.

Hypothesis 7: Long-term orientation has a significant negative relation with high amounts of debt.

4 Methodology

The main body of literature has focused on the Anglo-Saxon area. Therefore, this study aims to explore differences in Pan Europe and the difference in Christian faiths. Moreover, we will concentrate on medium-sized companies with 50-250 employees, with secondary data from Orbis. For the Cultural Values, we will use Hofstede’s Dimensions, and the Christian faiths will be collected from secondary data as well.

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