

The Influence of the Culture on Managers' Capital-Budget Decisions

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Abstract

Some researches in behavior accounting focus on the emotional affect and examine the influence of the emotional affect especially negative affect on capital budget decision-making. Kida, Moreno and Smith (2001) find that these affective reactions especially negative affect will influence managers' capital-budgeting decisions; managers will reject alternative that elicit negative affect even though it has higher economic values. Kida and Smith (2002) provide evidence that affective reaction will influence managers' risk-taking tendency in capital-budget decisions. However, these two studies fail to consider the role of different level individualism when they investigate the influence of affect on decision-making. Therefore, this study extends Kida et. al (2001) to investigate the role of culture in the context of affect and decision-making. This study finds that managers who are from low-individualism cultures are less likely to reject the alternatives that elicit negative affect but having high economic values than those managers who are from high-level individualist cultures.

Keyword: Emotional Affect; Individualism; Culture, Capital-budget Decisions

1. Introduction

Neurobiology and psychology theory suggests that affects are important components of decision processes. Affect refers to both mood and emotion. Mood such as feeling good or bad usually has no specific cause and no clear positive or negative affect; Emotion, however, has specific cause and clear positive or negative affect, such as angry or frustration. Recently, some researches in behavior accounting focus on the emotional affect and examine the influence of the emotional affect especially negative affect on capital budget decision-making.

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Kida, Moreno and Smith (2001) find that these affective reactions especially negative affect will influence managers' capital-budgeting decisions; managers will reject alternative that elicit negative affect even though it has higher economic values. Kida and Smith (2002) provide evidence that affective reaction will influence managers' risk-taking tendency in capital budget-making. Generally, according to prospect theory, managers are risk-avoiding for gains and risk-taking for losses in the absence of affective reaction. However, they find that managers are risk-taking (risk-avoiding) for gains (losses) in the presence of affective reaction, because they tend to reject investment alternatives that elicit negative affect and accept investment that elicit positive affect.

However, these two studies fail to consider the role of different level individualism that is one of Hofstede culture dimensions when they investigate the influence of affect on decision-making. As economic globalization brings people from different countries with various cultures working together, it is of great significance to examine whether people from different cultures will make different investment decisions under the same trigger events that elicit negative affect. According to individualism index which refers to the degree of people choose their own interests or alternatively take responsibility to act as a member of a group, people in low level individualism culture (collectivist culture) integrate into a group and always consider groups' interests first. However, people in high level individualism culture have little responsibility of sharing and more likely to look at their own interests first. And also Becker (1996, p. 16) says: "Individuals have less control over their culture than over other social capital. They cannot alter their ethnicity, race or family history, and only with difficulty can they change their country or religion. Because of the difficulty of changing culture and its low depreciation rate, culture is largely a 'given' to individuals throughout their lifetime".

Therefore, our study will extend Kida et. al (2001) to investigate the role of culture in the context of affect and decision-making. We propose that managers who are from low-individualism cultures are less likely to reject the alternatives that elicit negative affect but having high economic values than those managers who are from high-level individualist cultures. This study fits into the recent stream of research that examines capital budget decision-making from both sociology and psychology.

2. Theory and Hypothesis Development

2.1 The Role of Affect in Judgment and Decision

Neurobiology and psychology theory suggests that affects are important components of decision processes. How do such affective states influence people's judgment and decision? Several researches in psychology explain the affect influences on social judgments in terms of interpersonal choices. Bower (1981) indicates that people make many decisions based on their understanding and inference about the character and intentions of others, it is practically and theoretically important to understand how persons' feeling influence their judgment. Schachter (1959) suggested that person's emotional state may have significant influences on interpersonal choices. Forgas (1991) found that sad subjects reached decisions slower, less efficient and paid more attention to the personality and social skills of potential partners through an experiment that people were induced to experience a mild positive or negative affective state.

Other researches in accounting context also indicate the affect influence on capital budget decision-making according to interpersonal choices. Kida et al. (2001) suggest that interpersonal relationships are important characteristics in capital budget decision-making context, which can lead to different emotional reactions. So they examine four different scenarios and subjects have to make a choice between two product investments that are from two different sister divisions within a company. Subjects also received additional information that lead to negative feelings like angry toward one divisional manager who is associated with one decision alternatives. They find that managers tending to reject investment alternatives that elicit negative emotional responses and accept another investment alternative that elicit neutral emotional responses, even though the rejected alternatives have higher economic values.

Moreno, Kida and Smith (2002) extends Kida et al. (2001) to test the impact of affective reactions on risky decision making in accounting context; they also found that affect reactions can change managers' risky behavior: when affect was present, they tended to reject investment alternatives that elicited negative affect and accept alternatives that elicited positive affect, resulting in risk taking (avoiding) in gain (loss) contexts.

2.2 The Role of Culture in the Affect and Accounting Decision Contexts

Hofstede five culture indexes are widely accepted to analyze cross-culture research. Individualism is one of Hofstede five culture dimensions, which refers to the degree of people choose their own interests or alternatively take responsibility to act as a member of a group. According to Hofstede Individualism score (IDV), Western countries have very high IDV scores and Asian countries have low IDV scores. Countries with high IDV scores have weak group cohesion and little responsibility of sharing; Societies, however, with low IDV scores, have strong cohesion, strong loyalty and responsibility for their groups. In addition, people in low IDV countries consider their groups' interests before their own needs.

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According to the above theories, we propose that managers who are from low individualism cultures are less likely to be influenced by negative affect when they make capital budget decisions than managers who are from high individualism cultures.

H: Managers from low individualism cultures still tend to accept higher economic value decision alternatives, even though these alternatives will elicit negative affect.

3. Method

3.1 Design

The experiment employed a 2 × 2 between-participants randomized design. All participants from Asian (low individualism) or Western (high individualism) cultures have significant business experience. Total number of participants will be same in both cultures.

3.2 Procedures

We will employ Kida et. al (2001) experiment design. For both groups—high individualism & low individualism, all subjects in both groups will be given the same background information regarding to the decision-making context which include four scenarios. Kida et. al (2001) argue that if decision behaviors are consistent under four different trigger events, it would be more convictive that affect has the influence on decision behaviors. We use the same idea as Kida et. al (2001), if two groups--- high individualism & low individualism make uniformly different decisions under four different trigger events, we can conclude that culture is also an important driven force in decision behaviors and the influence of affect on decision-making will be attenuated under low individualism culture.

3.3 Decision Scenarios

Kida et al. (2001) developed four decision scenarios with four different trigger events that were designed to elicit negative affective reaction. Subjects in both groups will receive each scenario that include two alternatives, one with higher economic values but eliciting negative affect and another one with lower economic values but eliciting neutral affect. Subjects will be asked to make a choice between two alternatives that are from two different sister divisions within a company. In this paper, we will use the same trigger events in Kida et al. (2001). The following scenarios are summarized from Kida et al. (2001):

Scenario 1	Subjects were told that they were a divisional manager who decided between two product investments. For each investment alternative, they were required to work with two different sister divisions that were run by two different managers. The subjects then received the information that one division manager was really arrogant, for example this manager indicated that he was a key person in the firm, which led to negative feelings toward this division manager.
Scenario 2	Subjects were told that they were a divisional manager who decided between two product investments which were run by two sister divisions' managers. Subjects received information that one division manager has very bad personality or working habit, such that this manager was very selfish; or always late for any meeting in company.
Scenario 3	Subjects were told that the final profit and cost had to be verified by their own cost analysts. Subjects were also told that one division manager initially misled them regard the project's potential profit.
Scenario 4	Subjects were told that one division manager offered extremely high price and unwilling to negotiate at a more acceptable price even though this division provided the same part at reduced price before.

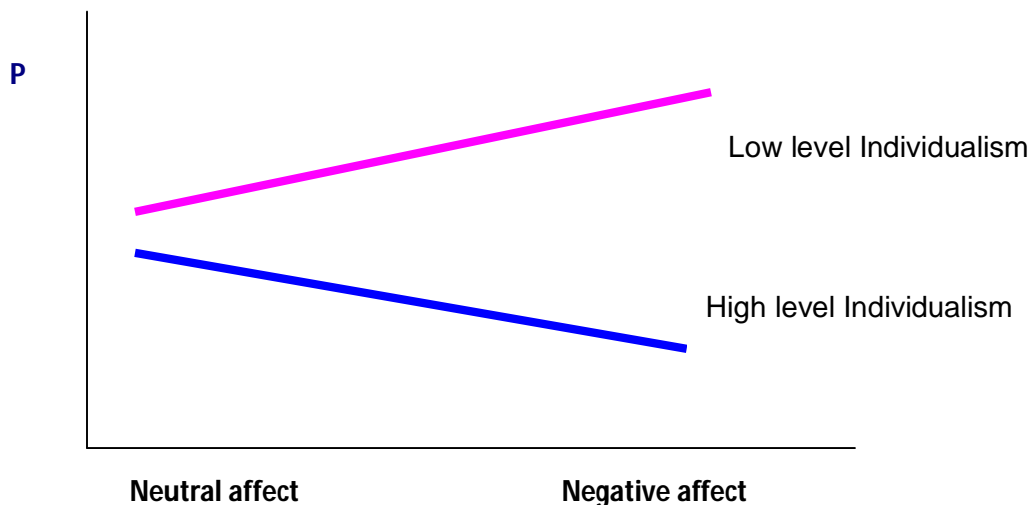
In each scenario, subjects also receive financial information about the profit of projects. The financial data will be designed to a negative affect with higher economic value and neutral affect with lower economic value, which examine whether the influence of negative affect on decisions behavior will be attenuated in the presence of low individualism culture.

3.4 Summary of Analysis

Experimental Design

	Negative affect	Neutral affect
High level Individualism (HIDV)	High	Low
Low level Individualism (LIDV)	Low	High

Dependent variable: P= Probability of managers that choose higher economic value alternative but elicit negative affect.



4. Results

Our analysis shows that managers who are from low-individualism cultures are less likely to reject the alternatives that elicit negative affect but having high economic values than those managers who are from high-level individualist cultures.

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