



MANIFESTED CULTURAL DIFFERENCES IN FINANCIAL DECISION-MAKING

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ABSTRACT

The foundation of rational decision-making is based on the principles established by von Neumann and Morgenstern. These assumptions and tenets are prevalent in the field of conventional finance. However, with the advent of the field that came to be known as behavioural economics, there was sufficient evidence to suggest that the rational economic model is inadequate in thoroughly modelling decision-making. There were numerous studies empirically providing support for how varied internal and external elements beyond the control of the decision-maker have a significant role in shaping the ultimate choice. This review article primarily centres on the role of culture in individual financial decisions. The review commences by examining the identification and definition of cultural regions within the realm of psychology. It subsequently proceeds to synthesise research findings and draw comparisons across these different cultural regions. Additionally, the review explores the interaction between culture and individual cognition and centres the analysis of these manifested differences around three key domains which connect personal aspects to broader societal contexts.

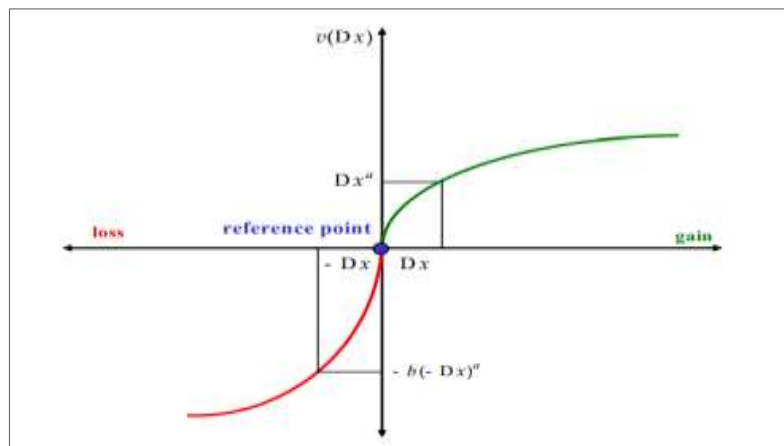
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INTRODUCTION

The foundation of rational decision-making is based on the principles established by von Neumann and Morgenstern in their influential publication in 1944. This work serves as the essential framework for expected utility theory. An investor with rational decision-making tendencies establishes their asset allocation by optimising their risk preference in consideration of their risk capacity. He exhibits impartiality in his assessment of risk perception. Samuelson (1969) identified a key implication of rational decision making in relation to the asset allocation problem. Specifically, in an efficient market, a rational investor characterised by constant relative risk aversion will engage in portfolio rebalancing, provided that their risk capacity permits such actions. The assumption of constant relative risk aversion is widely prevalent in the field of traditional finance.

Kahneman and Tversky (1979) developed an alternative model for decision making known as prospect theory. Prospect theory, although not originally formulated as a prescriptive framework for decision-making, operates as a descriptive model by virtue of its reliance on substantial empirical evidence obtained from controlled experiments conducted in laboratory settings. According to prospect theory, investors demonstrate consistent biases in their risk perception and their risk preference is influenced by whether they are assessing lotteries that involve gains or losses. Investors demonstrate a heightened level of sensitivity towards losses in comparison to gains, a phenomenon commonly known as loss aversion. This sensitivity to losses is particularly evident in the context of lotteries, where investors tend to display risk aversion. In situations when investors are faced with the prospect of certain losses, they often choose for risk-taking behaviour instead. Figure 1 portrays a value function that is representative of prospect theory. The notion of a reference point is employed to classify payoffs into two distinct categories, namely gains and losses. In the context of decision-making, the value function exhibits a steeper slope when it comes to losses, resulting in an S-shaped pattern (Kahneman & Tversky, 1979).

Figure 1: Value Function by Kahneman and Tversky (1979)



Moreover, empirical findings suggest that individuals have a tendency to assign excessive importance to low probability, while assigning insufficient credence to probabilities that are intermediate or big. Hence, there exists sufficient evidence to suggest that the Rational Economic Model is insufficient in thoroughly capturing the process of decision-making. Various internal and external elements outside the control of the decision-maker play a significant role in shaping the ultimate decision. The prevalent approach in the discipline of finance maintains that the returns of assets are dependent on the comprehensive rationality demonstrated by decision makers. Rational judgements are distinguished by a set of axioms that has universal applicability and are independent of cultural variations. The primary emphasis of this review article revolves on the role of culture in facilitating comprehension of the financial decisions that individuals undertake in their daily lives.

The examination of financial decision-making across different cultures has become a subject of interest due to the increasing interconnectedness of individuals and nations, driven by the phenomenon of globalisation (Nisbett, Peng, Choi, & Norenzayan, 2001).

CULTURAL REGIONS AND THEIR INFLUENCE

Numerous authors over the latter part of the twentieth century have engaged in speculation on the fundamental issues that societies encounter, which give rise to unique cultural aspects (for a comprehensive review, refer to Hofstede, 2001). The prevailing criterion employed to classify societies is their level of economic advancement or modernization. The concept of arranging civilizations along a unidimensional spectrum, ranging from traditional to contemporary, was widely embraced throughout the 19th and 20th centuries due to the prevailing notion of progress. However, it is important to acknowledge that there are cultural aspects that are not directly linked to economic development.

The objective of psychological theories about cultural differences is to gain insight into the cognitive processes, behavioural patterns, and perceptual frameworks shown by individuals hailing from diverse cultural origins. These theoretical frameworks facilitate the comprehension of disparities in cognitive processes, emotional experiences, social interactions, and other psychological phenomena throughout a range of civilizations.

Harry Triandis, Hazel Markus, and Shinobo Kitayama, esteemed social psychologists, contribute to the integration of culture within the field of psychology by their assertion that the collective values held by social groups significantly influence the cognitive, emotional, and social processes of people. Triandis et al. (1988, 1996) differentiate between organisations based on individualist and collectivist principles, as well as individuals based on allocentrism and idiocentrism. According to Triandis (1996), these cultural syndromes may be characterised as multidimensional constructs that encompass common attitudes, beliefs, norms, role and self definitions, and values among members of a certain culture, all organised around a central subject. Markus and Kitayama (1991) and Kitayama and Markus (1995) suggested a "collective constructionist" model of independence-interdependence as part of their endeavour to provide a comprehensive theory that accounts for variations peculiar to different communities. According to Kitayama et al. (2004), it is contended that "core cultural ideas" manifest themselves in "key ideological and philosophical texts and institutions at the collective level." This, in turn, facilitates the process of "cultural shaping of psychological reality," thus influencing "customs, norms, practices, and institutions."



Individualistic societies prioritise the pursuit of personal interests over accommodating the goals of others. The appreciation for uniqueness and self-expression is commonly upheld in cultures of this nature. In contrast, collectivistic societies perceive the concept of the "self" as an integral component of a larger collective entity. Individuals are often anticipated to collaborate with their respective ingroups in order to achieve objectives, adapt their own conduct based on social circumstances, and strive to conform and foster group cohesion. Yates and de Oliveira (2016) have posited that these variations are responsible for a significant portion of cross-cultural variability in decision-making, including choice modes, preferences, negotiating strategies, inventiveness, and other related factors (Yates & de Oliveira, 2016).

According to the *cushion effect*, it may be argued that in a collectivist society, such as China, individuals are afforded a safety net, which subsequently leads to a reduced level of risk aversion among them. In individualistic societies, such as that in the United States, there exists a more constrained safety net, leading people to exhibit greater aversion to risk (Weber & Milliman, 1997). While it is common to draw a comparison between collectivism and individualism, such an approach might be overly simplistic. It is important to recognise that cultures exhibit a multitude of differences beyond this dichotomy. An underexplored area of research pertains to the potency of cultural norms, despite their close association with various phenomena. Cultures that are categorised as "tight" exhibit a higher prevalence of social norms that are strictly upheld, while "loose" cultures possess a more limited set of standards that can be deviated from to a certain degree without facing severe repercussions (Gelfand, Nishii, & Raver, 2006; Gelfand et al., 2011). The prevailing paradigm for interpreting cultural differences has predominantly focused on the individualism/collectivism dichotomy. However, it is worth considering that many of these distinctions may alternatively be elucidated by variations in tightness/looseness. There exists a moderate correlation between the two variables, wherein collectivistic societies tend to exhibit higher levels of tightness compared to individualistic ones. This phenomena has the potential to provide light on the inclination of collectivists to prioritise seeking information from others during decision-making, in contrast to individualists. This habit may arise from individuals' tendency to prefer adherence to society norms.

The concept of cognitive style has garnered considerable attention within the realm of research on cultural differences in decision-making (Choi et al., 2004). The use of cognitive style as a framework has been applied to explore several aspects of decision-making, such as people' discerning focus on information and their cognitive mechanisms related to forward-thinking. Holistic thinking is a cognitive attitude that is frequently associated with civilizations coming from East Asia. The phenomenon under consideration is distinguished by its focus on the contextual factors, its prioritisation of the interconnections between various entities, its underlying belief in the perpetual state of change in the universe, and its acceptance of apparent contradictions (Nisbett, Peng, Choi, & Norenzayan, 2001; Peng & Nisbett, 1999). Analytic thinking is frequently associated with Western cultures, displaying notable characteristics such as a predominant focus on the central object, a categorical rather than relationship-oriented viewpoint, a belief in the stability and predictability of the universe, and adherence to the principles of formal logic, including non-contradiction. Theoretical research has shown a connection between cognitive style and social orientation, indicating that individuals with an individualistic mindset tend to exhibit a generally analytic cognitive style, whereas those with a collectivistic mindset tend to display a relatively holistic cognitive style (Varnum, Grossmann, Kitayama, & Nisbett, 2010).

Geert Hofstede conducted a seminal study in the late 1970s that has become a highly cited framework for analysing cultural variances. Hofstede conducted a comprehensive survey with a sample size of over 116,000 workers from IBM across 40 different countries. The purpose of this survey was to investigate the work-related values of these individuals and examine the variations in these values across different dimensions of national culture. The findings of this study revealed that managers and employees exhibited differences in their values across six distinct aspects of national culture. Power gap refers to the extent to which individuals within a given society are willing to acknowledge and accept the unequal distribution of power within institutions and organisations. A significant power distance rating indicates the presence of substantial disparities in power and wealth within a certain culture, which are accepted and permitted. The concept of individualism against collectivism pertains to the extent to which individuals prioritise their own actions and identities over collective affiliations, emphasising the importance of individual rights over other considerations. Collectivism places significant emphasis on a cohesive social structure, wherein individuals anticipate that other members of their respective groups would assume responsibility for their well-being and provide them with protection. The concept of masculinity vs femininity pertains to the extent to which a given society values conventional masculine attributes such as accomplishment, authority, and dominance, in contrast to perceiving individuals of all genders as equals. Uncertainty avoidance refers to the extent to which individuals within a certain nation exhibit a preference for organised circumstances as opposed to unstructured ones, hence delineating their level of



uncertainty avoidance. The concept of long-term vs short-term orientation pertains to the extent to which a society is committed to upholding traditional values. Individuals residing within a cultural context characterised by long-term orientation have a propensity to direct their attention towards future prospects and hold in high regard the virtues of frugality, perseverance, and adherence to established customs and beliefs. Individuals with a short-term orientation exhibit a preference for immediate gratification and prioritise present circumstances. Moreover, they have a greater propensity to embrace change and do not perceive commitments as hindrances to the pursuit of change. The concept of indulgence vs restraint pertains to a cultural characteristic within a society that places emphasis on the pursuit of pleasure and enjoyment, as opposed to the regulation of behaviour by rigid social standards (Robbins & Judge, 2021).

National culture refers to the enduring individual encounter that is sometimes referred to as the "collective programming of the mind," which serves as a distinguishing factor between different groups of individuals (Hofstede, 2001; Hofstede & Bond, 1984). The aforementioned cultural values exhibit a profound level of integration inside individuals from an early stage of development, and frequently endure by aiding customers in establishing enduring objectives over the course of their lifetimes. The examination of the direct influence of national culture and economic circumstances on the systematic variations in consumer behaviour across different nations has been a prominent area of interest in marketing research, both in terms of studying firms and consumers. Petersen et al. (2015) conducted a study that revealed a direct influence of national culture on consumer financial decision-making. Additionally, the study demonstrated that national culture also plays a moderating role in the effectiveness of marketing efforts by financial services firms. These findings imply that financial services firms should consider national culture as a crucial factor in their customer management strategies. Hofstede's seminal publication, "Culture's Consequences," in 1980 is widely recognised as a significant catalyst for fostering interdisciplinary study across the fields of cultural and economic sciences, with a special emphasis on the realm of Business Studies. Subsequently, there has been a surge in curiosity regarding the elucidation of deliberately divergent occurrences by the utilisation of cultural factors within several domains associated with the field of Business Studies.

The importance of Hofstede's aspects of national culture in determining nations' tax evasion behaviours has been postulated by Tsakumis et al. (2007) and Richardson (2008). High power distance settings are distinguished by the presence of power and wealth disparities, wherein those in positions of power have distinct privileges. In individualistic cultures, there is a tendency to establish norms and processes that are uniformly implemented in order to promote fairness. Consequently, it may be inferred that the tax system in such cultures will also adhere to these principles of equity. In low uncertainty avoidance contexts, tax regulations often exhibit a tendency towards vagueness and complexity, as there exists a diminished imperative to mitigate uncertainty or ambiguity. In societies characterised by a masculine culture, there is a strong emphasis on achieving material success in a world that is perceived as unjust (Hofstede, 2001). Conversely, in feminine societies, there is a focus on safeguarding nurturing values and a general belief in the inherent fairness of the world, which should guarantee a minimum standard of living (Richardson, 2008; Tsakumis et al., 2007). According to Khlif (2016), it can be inferred that a strong manifestation of masculinity within a certain nation is associated with reduced levels of tax compliance and an increased likelihood of tax evasion.

Individual Risk-Taking Behaviour

Studies done on risk aversion have identified significant variances across the cultural locations indicated above. In a study done by Bontempo, Bottom, and Weber (1997), participants from Hong Kong, Taiwan, the Netherlands, and the United States were presented with a variety of lotteries and were afterwards requested to make a selection. The researchers have observed that students in Hong Kong and Taiwan exhibit a greater degree of risk aversion, which is largely driven by the amount of prospective losses rather than the possibility of benefits compensating for these losses. This finding contrasts with the behaviour of students in Holland and the United States. Previous research has observed that Asian participants tend to have greater levels of risk tolerance and lesser levels of loss aversion when faced with financial risk, in contrast to persons from the United States and European countries (Fan & Xiao, 2006). Weber and Hsee (1998) proposed the "Cushion-hypothesis" as a theoretical framework to explain this phenomenon. According to their assertion, under a collectivist cultural context like China, individuals have the potential to get increased support from their familial and social networks in times of economic adversity. As a result, individuals experience a diminished awareness of financial risk. In alternative decision-making contexts, particularly those pertaining to health hazards, persons of Asian heritage exhibit a higher propensity for risk aversion. This inclination is consistent with the significant levels of Uncertainty Avoidance Index identified throughout this demographic.



The predisposition towards probabilistic thinking of a person is influenced by the cultural milieu in which they inhabit. The research done by Wright and Phillips (1980) revealed that individuals from Hong Kong have a tendency to offer more extreme probability predictions, such as "100%" or "no chance," when engaging in probability assessment tasks. On the contrary, individuals hailing from Britain have a heightened inclination to articulate their assessments by employing a broader spectrum of numerical possibilities. Yates, Lee, and Shinotsuka (1996) propose that the overconfidence bias observed in probability judgement might potentially be ascribed to the impact of collectivist societies. These cultures place a high value on conformity and prevent the open presentation of counter-arguments inside educational environments.

Before initiating the decision-making process, individuals with varied cultural origins interact with their environment in unique ways. One example that exemplifies this phenomenon may be observed in the differentiation between the prioritisation of positive versus negative information. This distinction may serve as an indicator of an individual's propensity to pursue opportunities or evade potential risks (Higgins, 1997). The study done by Hamamura, Meijer, Heine, Kamaya, and Hori (2009) revealed that persons from Canada and the United States had a propensity to selectively remember and retain a larger quantity of positive information in comparison to negative information. This finding was derived from participants' engagement with hypothetical life experiences or product evaluations. American individuals saw negative ratings as being less beneficial. Based on the findings of Hamamura et al. (2009), the investigation including participants from Japan demonstrated that they had either a reversed preference or a comparable degree of memory preservation for approach and avoidance-related information.

In a hypothetical situation involving stock trading, it was discovered that Canadians had a greater inclination compared to their Chinese counterparts towards engaging in the acquisition of equities that demonstrated an upward trend. The aforementioned result indicates that those residing in Canada had a greater propensity to view an upward trajectory in stock prices as a beneficial opportunity for making investments. Chinese participants had a greater inclination, in comparison to their Canadian counterparts, to actively pursue the acquisition of decreasing stocks. As a result, those originating from China had a greater propensity to see declining trends as advantageous opportunities. The study revealed that Canadians had a higher propensity to divest from depreciating stocks in comparison to their Chinese counterparts, with respect to stock selling activity. Conversely, the Chinese shown a higher propensity to sell appreciating stocks in comparison to Canadians. The cognitive style differences have been ascribed to these findings (Ji, Zhang, & Guo, 2008).

Personal Values

The concept of "value" pertains to the divergence in decision-making across individuals, which is impacted by their distinct preferences and priorities. In the realm of decision making, it is crucial to take into account the capacity to predict the extent to which the individual receiving a choice will have positive or negative attitudes towards the characteristics or outcomes linked to the decision. The presence of diverse cultural values leads to the emergence of contrasting assessments of the attractiveness or unattractiveness of certain decisions. According to Varnum and Kitayama (2011), individuals residing in former frontier regions within the United States exhibit a greater inclination towards choosing unique names for their newborns. This phenomenon could potentially be attributed to the impact of frontier environments, which fostered a culture emphasising self-sufficiency and consequently instilled a preference for individuality. Individuals living in areas of the United States that have a higher prevalence of pathogens show a reduced desire to endorse third-party candidates. This phenomenon might perhaps be explained by the tendency towards conformity that is encouraged by the greater levels of disease prevalence in these regions (Varnum, 2013). This part offers a comprehensive analysis of various cultural value differentiations, along with an exploration of how societies modify their evaluation of potentialities through the passage of time.

There exists variation among cultures in terms of the extent to which personal values have impact on decision-making processes. Based on the findings of a study done by Savani et al. (2008), empirical evidence indicates that individuals from India have a tendency to make judgements that are comparatively less impacted by their own preferences when compared to students from the United States. As previously stated, persons residing in Indian and several other collectivist civilizations commonly utilise decision-making strategies that emphasise the inclusion and deliberation of others. Therefore, the inclusion of external values and expectations, alongside one's own, has importance in the decision-making process. From this perspective, it may be reasoned that the impact of the decision maker's personal beliefs would be relatively less in a collectivist culture, where fewer factors need to be considered. In collectivist societies, individuals may find value in making decisions that conform to community norms, rather than placing emphasis on their own particular preferences. In particular research, it was observed



that individuals from both Brazil and the United States expressed a propensity to adhere to societal standards while making decisions on their behaviour. Furthermore, a study conducted by Bontempo, Lobel, and Triandis (1990) revealed that Brazilians had a greater inclination compared to Americans in expressing contentment by adherence to these norms. Savani et al. (2011) conducted a study which revealed that persons from India did not exhibit feelings of limitation or load when participating in decision-making procedures that required accommodating the preferences of others. Hence, whereas personal values hold considerable significance in the decision-making process of individuals originating from Western cultures, they appear to possess diminished influence in other cultures marked by collectivism and tightly-knit social structures. Research findings indicate that individuals residing in North America have a strong inclination towards favouring choices that are closely linked to their own identity. The phenomenon known as the "endowment effect" refers to the tendency of those who possess an item to assign a higher value to it compared to individuals who do not possess the same item and are potential purchasers. According to the findings of Maddux et al. (2010), the phenomena exhibited greater prevalence among Canadian and American people in comparison to those from different Asian ethnicities. The impact was notably more pronounced among Canadian participants when the cognitive connection between the self and the item was intentionally reinforced in the experimental setting.

Time Orientation

According to Hofstede (2001), the concept of long-term orientation pertains to a culture that is characterised by a forward-looking and dynamic perspective, whereas short-term orientation is associated with a culture that is rooted in tradition and focused on the past. Asian nations such as China, Hong Kong, Taiwan, Singapore, Japan, Korea, and Thailand are known for their long-term oriented cultures, whereas Canada, the United States, the United Kingdom, New Zealand, Australia, the Philippines, Nigeria, and Zimbabwe are characterised by their short-term oriented cultures. According to Hofstede's (2001) research, business managers in nations with a greater emphasis on long-term orientation tend to see qualities such as tenacity, patience, thrift, and self-reliance more favourably. Hence, enterprises operating under long-term oriented cultures have a willingness to diligently cultivate robust market positions, without anticipating rapid outcomes.

Investment possibilities are primarily assessed based on their ability to generate long-term value, leading investors to prioritise long-term profitability above short-term rates of return. According to Chang and Noorbakhsh (2009), managers are not consistently compelled to prioritise short-term positive returns, hence facilitating the development of long-term projects. In accordance with this notion, company leaders in cultures that prioritise long-term orientation are more inclined to prioritise profit objectives over a span of 10 years, whereas cultures that emphasise short-term orientation tend to prioritise profit goals for the current year (Hofstede et al., 2002). Similarly, the implementation of management strategies aligned with a long-term perspective is associated with the provision of extended employment opportunities, hence ensuring sustained job security for organisational personnel (Newman & Nollen, 1996).

The financing option of enterprises in a diverse range of nations can be significantly and economically explained by the presence of long-term orientation. The discovery holds significant theoretical and practical implications. In order to comprehensively analyse the financing choice of enterprises, it is important to consider the societal context, since the preferences of managers towards bank or bond finance may be impacted by the prevailing societal norms and values (Antonczyk, Breuer, & Salzmann, 2014).

CONCLUSION AND FUTURE DIRECTIONS

Culture is an inherent aspect of all societies, and individuals are required to acquire knowledge and understanding from the cultural milieu in which they reside. Therefore, it may be argued that culture exerts a significant and enduring influence on individuals' cognitive processes, including their perception, cognition, and decision-making abilities. Despite being recognised in several other domains, cultural differences have not received sufficient attention from the finance research community. One primary factor may be the longstanding perception of finance as a field primarily concerned with the rational decision-making of actors within ideal or less-than-ideal circumstances. The incorporation of cultural aspects into the study is a logical progression in light of the development of behavioural finance.

The influence of emotions is significant in the process of making economic and financial decisions. Various emotions are associated with distinct propensities for engaging in risky behaviour. As an instance, the experience of rage has been found to potentially elicit a tendency towards risk-seeking behaviour, whereas the experience of grief has been associated with a propensity for risk-avoidance. The universality of core emotions is observed across many nations, while distinct cultural contexts may promote certain emotions while inhibiting others (Aaker



& Williams, 1998). To what degree do emotions play a role in the variation of risk-taking behaviour and financial decision making across different cultures? Strategies for designing financial solutions that cater to diverse cultural preferences. Is there a higher level of attractiveness towards high-risk items in Asian countries, for instance? Does the accumulation of experience with financial goods lead to a modification of risk preferences as time progresses? The phenomenon of globalisation has led to the inevitable encounter and interaction between many cultures. The increasing necessity and feasibility of cross-cultural research in finance and financial markets are evident. It is posited that a more comprehensive comprehension of the effects of cultural backgrounds, as well as an understanding of other country-level variables such as religious composition, fatalism, political ideology, and so forth, will contribute to a greater understanding of the evolution of financial markets and enhance their operational effectiveness.

With the rapid process of globalization, different cultures inevitably confront and interact with each other. This makes cross-cultural studies in finance and financial markets more necessary and at the same time more feasible. We believe a deeper understanding of the impacts of cultural backgrounds, along with an understanding of other country-level factors like religious composition, fatalism, political ideology, etc. will help us gain more insights of the development of financial markets, and facilitate higher efficiency.

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