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Cross-Border Acquisitions: A Country-Level Analysis

An Honors Thesis submitted in partial fulfillment of the requirements for Honors in the
Georgia Southern Parker College of Business.

By
Jenny Heller

Under the mentorship of *Dr. Katia de Melo Galdino*

ABSTRACT

Country-level factors play an important role in the success or failure of cross-border acquisitions (i.e., acquisitions where the acquiring and target firms are in two different countries). If we are to understand and improve the success rates of these acquisitions, we must explore this issue in more depth. As globalization continues to emerge around the world, cross-border acquisitions have become a common way to enter a new foreign market. There is limited research available so far for these acquisitions on the country-level. Currently, cross-border acquisitions have failure rates of up to 70%. We analyze acquisition premium and use three dimensions of distance - administrative, economic, and financial - to understand how these country-level factors affect the performance of cross-border acquisitions. We collected data on acquisitions announced between 2011 and 2014 from the SDC database. We have 108 deals in our final sample used to conduct the statistical analyses. We found that while premium is negatively related to acquisition performance, this relationship is contingent on administrative and financial distances.

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April 2021
Parker College of Business
Honors College
Georgia Southern University

ACKNOWLEDGEMENTS

I would like to acknowledge all of the people who helped make this research paper possible. Firstly, this study could not have been completed without the expertise of Dr. Katia Galdino, my thesis advisor. She has been a great mentor every step of the way.

Secondly, I would like to acknowledge Dr. Trey Denton, the previous Honors Program business advisor, for helping me prepare for my thesis project by teaching me about the process.

Lastly, I would like to thank my parents for supporting me throughout my journey through college, and for always encouraging me to do my best.

INTRODUCTION

As globalization continues to emerge around the world, cross-border acquisitions (CBAs) have become a common way to enter a new foreign market. There is limited research available so far for these acquisitions at a country-level, and currently CBAs have failure rates of over 70 percent (Christensen, Alton, Rising, & Waldeck, 2011). Between 1990 and 2008, the number and value of CBAs increased by a factor of about ten and cross-border deals now account for the vast majority of total global foreign direct investment (UNCTAD, 2008). If we are to understand and improve the success rates of these acquisitions, we must explore these factors in more depth. In this research paper, we explore the relationship between acquisition premium, or the percentage difference between the trading price of the target's stock before the announcement of the acquisition and price per share paid by the acquiring firm' (Haunschild, 1994), and different distance factors (i.e., the degree of similarity between the acquirer and target countries) that should affect the success of CBAs.

Globalization is a relatively new concept that has achieved widespread development in the past 20 or so years. With this globalization comes a rise in CBAs as firms see new opportunities outside of their home countries. But lack of research and understanding on the factors that influence success when acquiring firms abroad leads to a strikingly large failure rate for CBAs (Bower, 2001). This may be accounted for due to firms being unable to create value from the newly acquired firm (Malhotra & Zhu, 2013). Previous research establishes that although acquirers generally pay a premium to take over a firm, the excess payment might not be recovered by the synergy that acquisitions provide (Krishnan, Hitt, & Park, 2007).

We suspect that a CBA's ability to create value may be impacted by not only the premium paid, but also the differences between the acquirer's and target's countries. Hence, the purpose of this research is to develop an understanding of how different distance factors, particularly administrative, economic, and financial distance, impact the relationship between premium and CBA performance.

Distance factors can be defined as any differences or similarities between two countries, not only physical distance. In initial studies, only geographic distance was considered (Ragozzino, 2009), but more attention has been brought to other distance factors in recent years. For example, Berry, Guillen, and Zhou (2010) established nine distance dimensions that could be useful in measuring CBA performance, namely administrative, cultural, demographic, economic, financial, geographic, global connectedness, knowledge, and political distances.

We analyzed three of these distance dimensions in our study - administrative, economic, and financial. Because we are looking for how premium affects the performance of CBAs, these three dimensions are most relevant for explaining differences in terms of financial development of the countries. Hence, we ask: *How do these three distance dimensions influence the relationship between premium and CBA performance?* By analyzing these dimensions, we can improve our understanding of how they impact the relationship between acquisition premium and performance. By doing so, we provide managers involved in CBAs with more tools needed to increase their success chances.

LITERATURE REVIEW

Acquisition Premium

First, what is a premium? The initial acquisition (or bid) premium refers to the difference between the price proposed for a target firm and the pre-acquisition market value (Comment & Schwert, 1995). We define premium as the offer price of an acquisition after announcement, plus an extra fee. The premium is the extra money you have to spend in order to purchase a firm. For example, a firm valued at \$2 million sells for \$3.5 million. The extra \$1.5 million that was paid is its premium. The issue with premium is that it skews the true value of a target firm. When a premium is set too high, the acquiring firm will not be able to create value (Bower, 2001).

It is important to note that premium negatively affects acquisition performance. This has been previously established in numerous research papers (Beckman & Haunschild, 2002; Hayward & Hambrick, 1997; Sirower, 1994; Sirower & Sahni, 2006). When a premium is higher, the acquisition performance measures lower. Essentially, the more money paid that is over the true value of a firm, the harder it will be to have a successful acquisition. The higher the premium, the greater the pressure that shareholders exert on managers to realize the returns needed to achieve the net present value of the investment. Any delay in integrating operations across the two firms has a negative impact on the net present value (Malhotra & Zhu, 2013). Another reason for a negative association may be because competitors and other experts in the field recognize the true value of the firm and realize that creating value at such a high premium would be a difficult task (Bower, 2001).

Distance Factors

Without much conclusive research on the consequences of distance factors for CBA performance, it is important that we do not overestimate their impact as well as

underestimate it. Distance is a multidimensional concept, meaning that there is no single correct approach to analyzing it, and it is important to account for different distance dimensions.

Globalization is a driving force of CBAs, and it is largely responsible for the recent increase in research pertaining to their success. As mentioned previously, initial research on the relationship between CBA performance and premium focused mostly on very apparent distance factors, such as geographical distance and political distance (Ragozzino, 2009; Bertrand, Betschinger, & Settles, 2016; Baik, Cho, Choi, & Kang, 2015). Eventually, along with the rapid growth of globalization, researchers considered several other distance dimensions as potential factors on CBA performance (i.e., Berry et al., 2010; Dow & Karunaratna, 2006), and expanded their studies to include these dimensions in their observations and predictions.

There is limited research available on the administrative distance dimension. Zhu, Xia, and Makino (2015) performed a study to see the moderating effects of institutional distance, language differences, and diplomatic relationships on the relationship between integration versus autonomy on the acquiring firm's performance. The authors found that the effect of institutional distance alone was insignificant, however both language differences and institutional distance together strengthen the relationship. In contrast, they found evidence that diplomatic relationships weakened the overall relationship.

So far, research on economic distance has provided inconsistent results. Liou and Rao-Nicholson (2017), using data from South African acquirers, found that results were not significant when using return on equity (ROE) as a dependent variable. However, the same researchers performed a second study and found that economic distance had a

negative impact on return on assets (ROA), as a moderator of the relationship between firm age and ROA (Liou & Rao-Nicholson, 2019).

Prior research has used accounting measures, such as ROE or ROA, to measure financial distance (Liou & Rao-Nicholson, 2017, 2019). These measurements are used to determine a firm's recognized disadvantages, including a historical focus and undervaluing intangible assets (Rowe & Morrow, 1999). Many of the studies about financial distance are mainly focused on its relationship with cultural distance. There is little research available on the individual relationship between financial distance, CBA performance, and premium.

As for the other distance dimensions established by Berry et al. (2010), various levels of research have been completed. In recent years, there has been an increase in research pertaining to the cultural distance dimension and its impact on CBA performance and employee retention (Ahammad et al., 2014), but less research has been done on many of the other dimensions. Similarly, there have been studies done on the relationship between political distance and CBA performance, and how it affects an acquisition's ability to create value. (Alimov, 2005; Bertrand et al., 2016; Baik et al., 2015).

So far, very little research is available using the nine distance dimensions established by Berry et al. (2010) that were previously mentioned in this paper. Furthermore, we were unable to find research that explores several distance dimensions and their impact at the same time, and how they influence each other as well as the relationship between CBA performance and premium. We believe that this research is

imperative to properly understand the interdependence of distance dimensions and their overall impact on CBA premium and performance.

THEORY AND HYPOTHESES DEVELOPMENT

Based on previous research, we posit that premium is negatively related to performance. It is true that there has been plenty of research done to support this concept as true in general, but the relationship has not been as well studied specifically in CBAs as it has been in domestic acquisitions. Moreover, this is the baseline for our other three hypotheses.

Higher premiums make it difficult for acquired firms to create value. If it is harder to create value, overall performance is going to be lower. Therefore, premium negatively affects acquisition performance. Because we are specifically looking at acquisitions that are cross-border instead of domestic, and there is a lack of research in this area, we included this relationship as our first hypothesis. Formally stated:

***Hypothesis 1:** Premium is negatively related to CBA performance.*

Administrative distance includes forms of government, administration policies, and foreign and domestic laws. The more different the styles of government and laws in place are in the target country and acquiring country, the less successful the acquisition will be. Laws and policies enacted by governing bodies can encourage or dissuade successful acquisitions. We expect to see this reflected in the premium cost of the acquisition, in turn affecting the overall performance. Formally stated:

***Hypothesis 2:** Administrative distance moderates the relationship between premium and CBA performance.*

Economic distance includes different consumer levels and each country's current

economic standing. The economic makeup of a country impacts consumer decisions and affects a firm's ability to create value. The further apart in economic distance two countries are, the lower the chance is of having a successful acquisition. Formally stated:

Hypothesis 3: Economic distance moderates the relationship between premium and CBA performance.

Financial distance includes the gross domestic product (GDP) of the countries involved, the finances of both the target and acquiring firms, and how affordable the necessary resources are, as well as their availability and cost of transportation. When there is a greater financial distance between the two countries involved, there is more financial stress. This in turn will lower overall performance. Formally stated:

Hypothesis 4: Financial distance moderates the relationship between premium and CBA performance.

In sum, we believe that when these distances are high, they will strengthen the negative relationship between premium and performance and make acquisition success harder to achieve. Figure 1 shows the model with the predicted relationship between our independent variable, premium, and our dependent variable, CBA performance. On top we have our three moderators, namely, administrative, economic, and financial distances, which we have tested to analyze their effects on the relationship between premium and CBA performance.

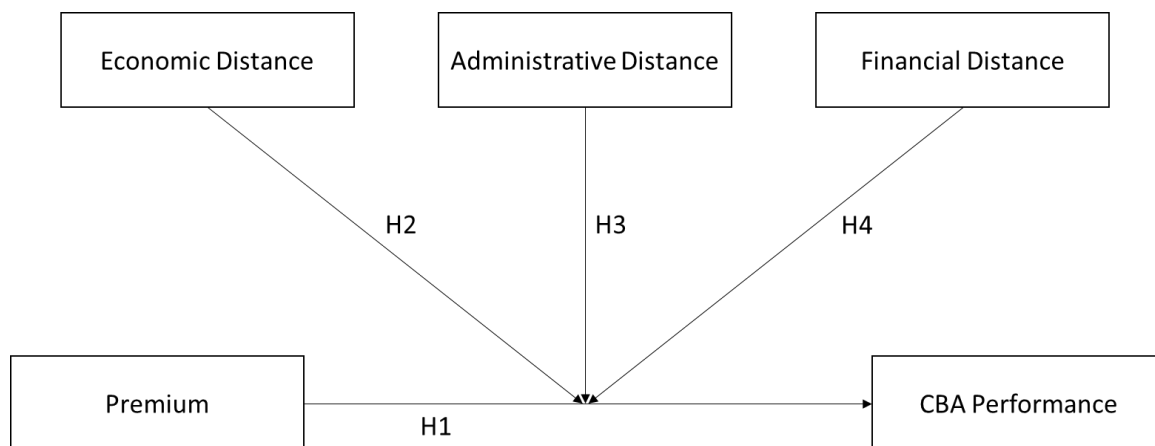


Figure 1. Conceptual Model

METHODS

Sample

To test our model, we began by compiling a sample of completed acquisitions by U.S. publicly traded firms reported in the Thompson Financial SDC Platinum database between the years 2011 and 2014. We then gathered performance information (i.e., announcement CAR) from the Center for Research in Security Prices (CRSP) using the Event Study functionality from Wharton Research Data Services (WRDS), which yielded a sample of 908 acquisitions. Out of these, 172 were cross-border. After accounting for missing data for the three moderating variables, our final sample consisted of 108 deals.

Measures

Our dependent variable is *performance*, which is accessed by announcement CAR using a three-day window. Announcement cumulative abnormal return (CAR) refers to how the market evaluates the value of the target firm after the acquisition is announced (Haleblian & Finkelstein, 1999; Hayward, 2002). As stated above, the announcement CAR was gathered from the CRSP database in WRDS.

Our independent variable is *premium*, which we have already previously established as the difference between price paid and actual value. To calculate premium, we used the difference between the price paid per share and the target share price four weeks prior to the deal announcement date, as reported by the SDC.

We have three moderators: administrative distance, economic distance, and financial distance. To assess them, we used the measures developed by Berry et al. (2010). Administrative distance considers colonizer-colonized links, common languages and religions, and legal systems. Economic distance considers the acquiring and target countries' income, inflation, and imports and exports. Lastly, financial distance considers the two countries' private credit, stock market capacity, and listed associated companies.

We also controlled for several variables that could affect performance and, hence, serve as alternate explanations for our findings. First, we controlled for *ownership stake*, measured by obtaining the percentage of shares in the target firm purchased by the acquiring firm. Research has shown that ownership stake is strongly associated with post-acquisition performance (e.g., Chari & Chang, 2009). Second, we controlled for the *transaction value*, in dollars. Third, we controlled for *relatedness* between the acquiring and target firm's industry, which is one of the main variables influencing acquisitions' outcomes (King, Dalton, Daily, & Covin, 2004). Following Ellis, Reus, Lamont, and Ranft (2011), we compared the four, three, and two digits of the primary SIC code of both the acquiring and target firms, and coded deals from four (four-digit primary SIC code match) to zero (no match). Fourth, we controlled for *cash payment* using a dummy variable coded as one if the deal was completely financed with cash and zero otherwise. Prior research has shown that type of payment may influence CBA's outcomes (Dikova,

Sahib & Witteloostuijn, 2010)., Fifth, we controlled for the *acquirer advisors* by using the total number of advisors used by the acquiring firm, which has been shown to affect many CBA outcomes, including performance (Rajamani, van der Poel, de Jong, & Ongena, 2017). All these measures were collected using the SDC Platinum database. Finally, we controlled for the *geographic distance* between the acquirer and the target's countries, measured using the numbers provided by Berry et al. (2010).

RESULTS

We used ordinary least squares (OLS) regression to analyze the data. We ran our data through the software Stata in order to generate results. Table 1 shows descriptive statistics and correlations for the proposed variables. Table 2 reports the regression coefficients from the regression analyses with p-values in parentheses. We also provide graphic representation for the moderating relationships.

Model 1 in Table 2 is the baseline model, comprising only the control variables. The independent variable of interest, premium, as well as the main effects of the moderating variables, administrative, economic, and financial distances, were included in model 2. Each interaction term assessing hypotheses 2, 3, and 4 were included in Models 3, 4, and 5, respectively. Model 6 is the full model, comprising all the interactions.

Table 1. Descriptive Statistics and Correlations

Variable	Mean	SD	1	2	3	4	5	6	7	8	9	10	11
1 Performance	0.01	0.06	1.00										
2 Ownership Stake	90.75	20.53	-0.04	1.00									
3 Transaction Value	257.10	1695.00	-0.05	0.07	1.00								
4 Relatedness	1.73	1.81	0.18	-0.05	0.14	1.00							
5 Cash Payment	80.78	29.34	0.14	-0.01	-0.14	-0.06	1.00						
6 Acquirer Advisors	1.80	1.17	-0.02	0.11	0.52	0.13	-0.21	1.00					
7 Geographic Distance	1294.23	3131.48	0.10	-0.33	-0.08	0.01	0.20	-0.03	1.00				
8 Premium	47.27	268.74	-0.29	0.10	-0.11	-0.16	-0.14	-0.11	-0.06	1.00			
9 Administrative Distance	11.98	33.64	0.10	-0.26	-0.10	-0.02	0.21	-0.05	0.63	0.02	1.00		
10 Economic Distance	0.83	3.17	0.19	-0.13	0.14	0.12	0.07	0.04	0.43	-0.07	0.51	1.00	
11 Financial Distance	1.11	5.12	0.03	-0.16	-0.11	-0.10	0.17	-0.01	0.56	0.10	0.58	0.34	1.00

Table 2. OLS Regression with Performance as Dependent Variable

VARIABLES	(1) Controls Only	(2) Main Effects	(3) Admin. Dist.	(4) Econ. Dist.	(5) Finan. Dist.	(6) Full Model
Ownership Stake	0.00 (.301)	0.00 (.440)	0.00 (.359)	0.00 (.463)	0.00 (.404)	0.00 (.457)
Transaction Value	-0.00 (.121)	-0.00 (.154)	-0.00 (.164)	-0.00 (.155)	-0.00 (.170)	-0.00 (.173)
Relatedness	0.01 (.014)	0.01 (.081)	0.01 (.059)	0.01 (.090)	0.01 (.052)	0.01 (.060)
Cash Payment	0.00 (.004)	0.00 (.181)	0.00 (.228)	0.00 (.190)	0.00 (.238)	0.00 (.235)
Acquirer Advisors	0.01 (.086)	0.00 (.472)	0.00 (.497)	0.00 (.481)	-0.00 (.470)	-0.00 (.461)
Geographic Distance	-0.00 (.194)	-0.00 (.481)	-0.00 (.250)	-0.00 (.392)	-0.00 (.338)	-0.00 (.435)
Premium		-0.00 (.007)	-0.00 (.038)	-0.00 (.011)	-0.00 (.051)	-0.00 (.049)
Administrative Distance		-0.00 (.499)	0.00 (.063)	0.00 (.283)	0.00 (.487)	-0.00 (.328)
Economic Distance		0.00 (.068)	0.00 (.159)	0.01 (.093)	0.00 (.113)	0.01 (.295)
Financial Distance		-0.00 (.463)	0.00 (.373)	-0.00 (.395)	0.01 (.078)	0.01 (.087)
Admin. Dist. * Premium			-0.00 (.045)			0.00 (.331)
Econ. Dist. * Premium				-0.00 (.223)		-0.00 (.434)
Finan. Dist. * Premium					-0.00 (.014)	-0.00 (.083)
Constant	-0.05 (.079)	-0.02 (.348)	-0.03 (.265)	-0.02 (.372)	-0.02 (.304)	-0.02 (.364)
Observations	316	108	108	108	108	108
R2	0.04	0.15	0.17	0.15	0.19	0.19

Note: One-tailed p-values in parentheses.

Considering the controls, relatedness is the only variable that has a consistent significant relationship on CBA performance ($\beta = 0.01$, $p = .014$ in Model 1 and $\beta = 0.01$, $p = .014$ in Model 6). Considering our first hypothesis, we found that premium had a significant negative relationship to performance ($\beta = -0.00$, $p = .007$). This means that the higher the premium paid for the target firm, the lower the post-acquisition performance.

Hence, hypothesis 1, stating that premium is negatively related to performance, is supported.

Hypothesis 2, stating that administrative distance moderates the relationship between premium and performance, is negative and significant in Model 3 ($\beta = -0.00$, $p = .045$), initially corroborating the hypothesis. We also provide a graphic representation to further analyze this result, presented in Figure 2. Surprisingly, the graph shows that the relationship between premium and performance is contingent on administrative distance, but when the administrative distance is high, the relationship between premium and performance is actually positive. We further analyze this result in the discussion section. The interaction, nonetheless, is not significant in the full model ($\beta = 0.00$, $p = .331$). Altogether, the results do not provide complete support for hypothesis 2.

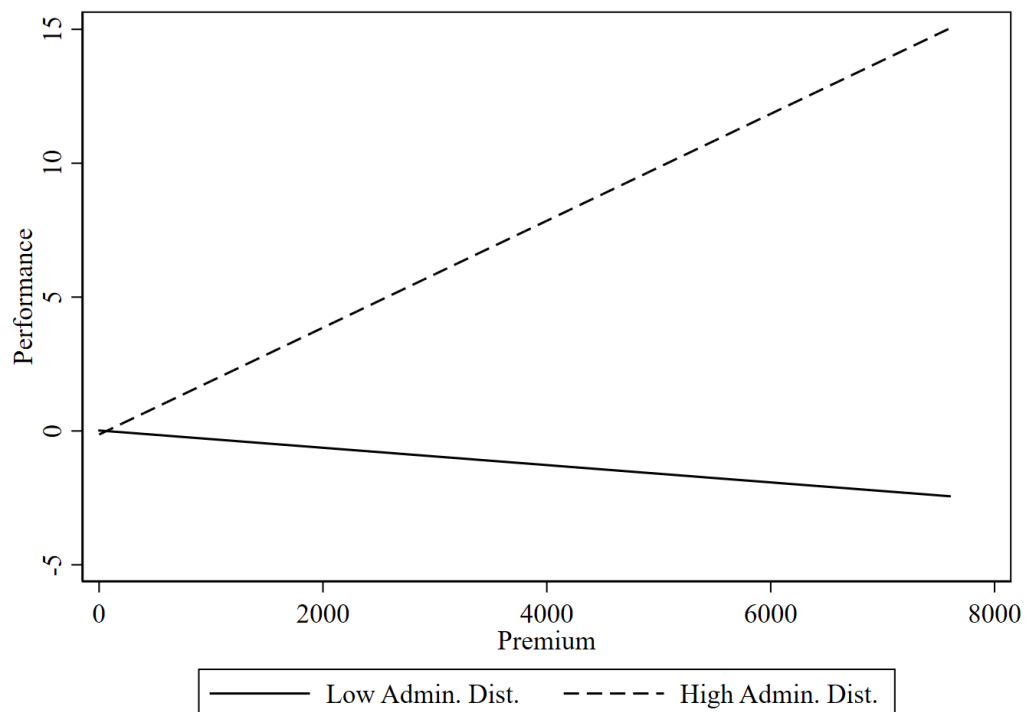


Figure 2. The Moderating Role of Administrative Distance

Hypothesis 3, stating that economic distance moderates the relationship between premium and performance, is not significant in Model 4 ($\beta = -0.00, p = .223$) nor in Model 6 ($\beta = -0.00, p = .434$). Hence, hypothesis 3 is not supported.

Finally, Hypothesis 4, stating that financial distance moderates the relationship between premium and performance, is negative and significant in Model 4 ($\beta = -0.00, p = .014$) and Model 6 ($\beta = -0.00, p = .083$), corroborating the hypothesis. We also provide a graphic representation to further analyze this result, presented in Figure 3. The graph shows that, as hypothesized, the relationship between premium and performance is contingent on financial distance. While at low levels of financial distance the relationship does not change, at high levels of financial distance the negative relationship between premium and CBA performance is strengthened. Hence, hypothesis 4 is supported.

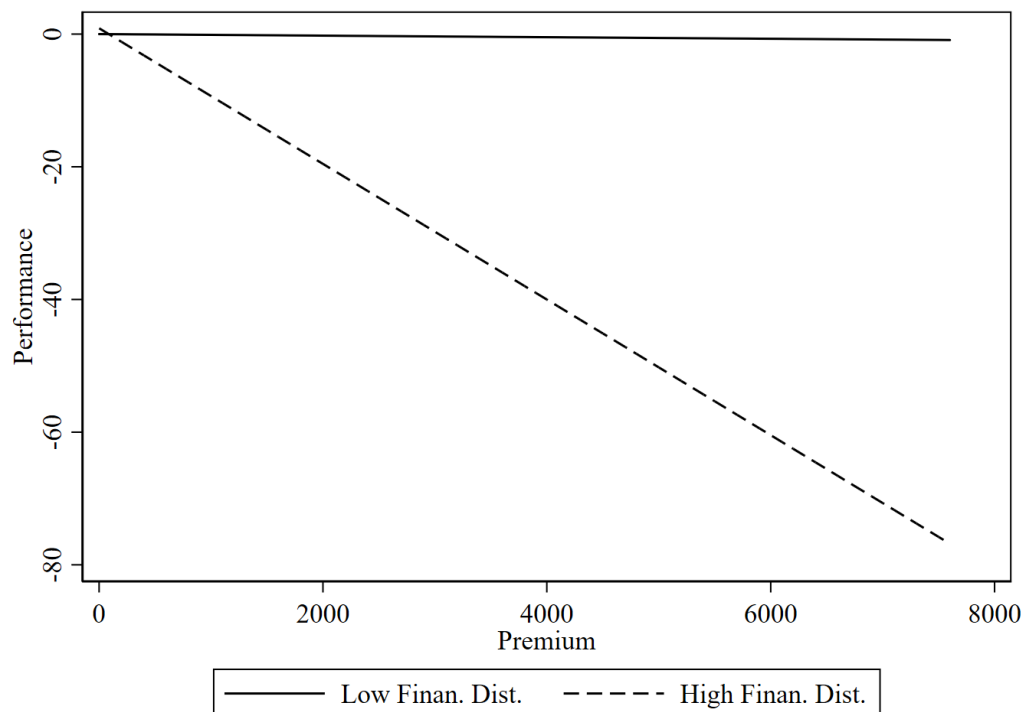


Figure 3. The Moderating Role of Financial Distance

CONCLUSIONS

After completing this study, we can safely say that premium negatively affects CBA performance. The relationship between premium and CBA performance is affected particularly by financial distance. Specifically, when the financial distance between the acquirer and the target country is high, the negative relationship between premium and CBA performance is strengthened. While administrative distance initially had a negative and significant moderating effect on the relationship between premium and CBA performance, this effect did not hold in the full model. And the graph suggests that administrative distance may actually weaken the negative effect premium has on performance. These initial results deserve further investigation. Furthermore, we found no support for the hypothesis that the relationship between premium and CBA performance is affected by economic distance.

Understanding this relationship between premium and performance can help managers run more successful CBAs. When a firm overpays for an acquisition, it has to make up for that investment first before it is able to create any value. Higher premiums make it difficult for acquired firms to first earn back what they have lost, and then try to create additional value on top of that. Moreover, creating value from CBAs is particularly difficult, because of the different country-level differences that play a role on the success of the deal. The more we understand about financial and administrative distances, as well as other dimensions of distance, the more we can improve success chances of CBAs, and in turn improve global connectedness.

Limitations and Direction for Future Research

The data we used in this study was from between the years 2011 and 2014. The oldest data we used is almost ten years old. For a more recent observation on CBAs, we could look at data from the past five years. Globalization is a continuous process that is only gaining momentum. This data may not be as relevant now as it was at the time of collection. For future research, it would be interesting to observe data on CBAs collected within a year or two of the study, and to see whether the relationships of interest change in any ways.

Another limitation we dealt with was missing data. Not every acquisition recorded by the SDC had data available on all three distance dimensions that we wanted to observe. While this missing data was most likely not enough to change the results of our study, it is always best to have all the data included in the analysis.

As for directions for future research, it would be interesting to look at how technology influences the success chances of CBAs. Technology is a fast-growing industry that is continuously developing and changing. Different levels of technology in countries involved in CBAs should be a major contributing factor for the success of these deals, likely affecting the relationship between premium and CBA performance.

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