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Do cross-border acquisitions create value? Evidence from overseas acquisitions by Chinese firms

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ABSTRACT

Based on the dynamic capability and organizational learning perspectives, we examine whether acquirers from emerging economies can create value for their shareholders in cross-border mergers and acquisitions, and the key drivers which may influence any such value creation. A sample of 367 cross-border mergers and acquisitions between 2000 and 2011 involving Chinese listed companies as the acquirers was analyzed to highlight the relationship between the cultural distance involved and the acquirers' market valuation. On average, such cross-border transactions created value for the acquirer's shareholders, but cultural distance was negatively related to the extent of such value creation. Larger firms, more experienced firms, and acquisitions within the same industry were found to be less affected by cultural distance, emphasizing the importance of learning and absorptive capability, but employing a financial advisor did not seem to help. Thus firms with greater absorptive capacity were found better able to overcome the difficulties caused by cultural differences. Implications for research and practice are discussed.

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1. Introduction

There has been extensive research on whether cross-border mergers and acquisitions (M&As) create or destroy value for the shareholders of the acquiring firms, but the findings from this stream of research have not been consistent. For example, Cakici, Hessel, and Tandon (1996), Doukas and Travlos (1988), Eun, Kolodny, and Scheraga (1996), Goergen and Renneboog (2004), a group led by Gubbi (Gubbi, Aulakh, Ray, Sarkar, & Chittoor, 2010), Markides and Ittner (1994), and Markides and Oyon (1998) found that the acquirers' stock price responded positively to the announcement of a cross-border acquisition, while Chakrabarti, Gupta-Mukherjee, and Jayaraman (2009) and Datta and Puia (1995) found a negative effect. Datta, Pinches, and Narayanan (1992) found no significant market reaction, but Conn and Connell (1990) found that the result is sensitive to the model used, and Reus and Lamont (2009) found that value creation depends on the absorptive capability of the acquiring firm. While there could be many explanations about the inconsistency in the findings from this stream of work, one reason could be the different national contexts where these studies were conducted and the methods applied. For example, while the majority of prior studies examined domestic mergers and acquisitions, some other studies examined cross-border M&As (Gubbi et al., 2010; Krug & Hegarty, 2001). There are differences in regulation (e.g., openness and taxes, Chakrabarti, 2001), investment opportunities (e.g., higher quality of resources in developed economies, Gubbi et al., 2010), and motivations for acquisitions. For example, multinationals from developed economies are more likely to exploit their existing assets (Makino, Lau, & Yeh, 2002), while many Chinese multinationals are more attracted by strategic assets not available at home (Deng, 2009; Luo & Tung, 2007). The inconsistent findings may also suggest the importance of considering the specific context.

While many of the prior studies have examined the actions of acquirers from developed economies (e.g., Barmeyer & Mayrhofer, 2008; Conn & Connell, 1990; Datta & Puia, 1995; Doukas & Travlos, 1988; Eun et al., 1996), a growing number of studies have begun to examine the phenomenon of M&As by acquirers from emerging economies (Aybar & Ficici, 2009; Bhagat, Malhotra, & Zhu, 2011; Boateng, Wang, & Yang, 2008; Chen & Young, 2010; Gubbi et al., 2010; Ning, Kuo, Strange, & Wang, 2014). "Emerging economies" here refers to less developed economies which have high growth

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potential and government policies favoring economic liberalization and the adoption of a free-market system (Arnold & Quelch, 1998; Hoskisson, Eden, Lau, & Wright, 2000). Some of those studies (for example, Chen & Young, 2010; Ning et al., 2014) have found positive stock price reactions while others (for example, Aybar & Ficici, 2009) have found the opposite.

Cross-border acquisitions by acquirers from emerging economies have usually been driven either by the quest for strategic resources overseas, such as a new technology, brand, talent, distribution channels, natural resources, or by the need to avoid institutional constraints at home (Child & Rodrigues, 2005; Deng, 2007; Luo & Tung, 2007; Rui & Yip, 2008). In order to catch up, acquirers from emerging economies have to learn, reconfigure their resources, and enhance their dynamic capabilities (Kogut & Zander, 1992; Teece, Pisano, & Shuen, 1997). This involves a significant amount of knowledge transfer, much of which is embedded in the society or people of the host country. Furthermore, compared with multinationals from more developed economies, new multinationals from emerging economies would lack the experience necessary for success in international business and their performance may be negatively affected (Haleblian & Finkelstein, 1999).

This study examined three research questions. First, to what extent acquirers from emerging economies can consistently create value for their shareholders in cross-border M&As. Second, whether the cultural distance between the home countries of the acquirer and target affects any such value creation was examined. Third, how the absorptive capability of the acquiring company can influence the relationship between cultural distance and value creation was considered.

In exploring what factors affect acquirers' performance in cross-border acquisitions, this study focused on cultural distance between the acquirer's and the target firm's home countries. Cultural distance is known to be an important factor in international business (Datta & Puia, 1995; Kim & Hwang, 1992; Kogut & Singh, 1988; Lee, Shenkar, & Li, 2008; Leung, Bhagat, Buchan, Erez, & Gibson, 2005; Li, Karakowsky, & Lam, 2002; Shenkar, 2012; Sirmon & Lane, 2004; Vaara, Sarala, Stahl, & Bjorkman, 2012), and it is often cited as an impediment to integrating cross-border acquisitions (Datta & Puia, 1995; Morosini, Shane, & Singh, 1998). Given that multinationals from emerging economies typically lack international experience and tend to learn in the process rather than exploit their existing knowledge, they may be particularly affected by cultural distance.

The dynamic capability and the organizational learning perspectives (Cohen & Levinthal, 1990; Kogut & Zander, 1992; Lane, Salk, & Lyles, 2001) emphasize the heterogeneity in firms' absorptive capacity. Absorptive capacity in this context refers to "...an ability to recognize the value of new information, assimilate it, and apply it to commercial ends" (Cohen & Levinthal, 1990: p. 128). As many previous studies (e.g. Lin & Germain, 1998) have documented, cultural distance can impede knowledge transfer. Therefore, this study also investigated how the negative effect of cultural distance might be mitigated to some extent by a firm's absorptive capabilities. The intention is to shed additional light on the key factors that affect the performance of cross-border M&As by emerging economy firms.

Based on the dynamic capability and organizational learning perspectives, we examine whether acquirers from emerging economies can create value for their shareholders in cross-border M&As, and the key drivers which may influence any such value creation. A sample of 367 cross-border mergers and acquisitions between 2000 and 2011 involving Chinese listed companies as the acquirers was analyzed to highlight the relationship between the cultural distance involved and the acquirers' market valuation. On average, such cross-border transactions created value for the acquirer's shareholders, but cultural distance was negatively related to the extent of such value creation. Emphasizing the role of learning and absorptive capability, we found that large firms, experienced firms, and non-diversified acquisitions were less affected by cultural distance, but employing financial advisors did not seem to help.

This research was intended to make the following contributions. First, it adds to an emerging stream of scholarly work examining the impact of cultural distance on cross-border acquisitions by new multinationals from emerging economies. There are considerable differences between acquirers from emerging economies and those from more developed economies. For example, many acquirers from developed economies tend to exploit their existing assets, while those from emerging economies are more likely to seek new strategic assets. Although both would involve knowledge transfer, the latter would be more challenging. Therefore, the effect of cultural distance could be even more important for cross-border acquisitions by firms from emerging economies.

Second, emphasizing the role of learning and absorptive capability, we have also identified several firm-level factors that can mitigate the negative relationship between cultural distance and value creation in cross-border acquisitions. In particular, firms with greater absorptive capacity were found better able to overcome the difficulties caused by cultural differences.

Cross-border acquisitions by acquirers from emerging economies are more likely to be driven by the motivation of acquiring strategic assets that can help them build or enhance competitive advantage. Most such assets are intangible in nature—technology, management skills, human capital, and so on. Communicating intangible information is exposed to cultural conflicts. This study investigated how cultural distance affects the performance of Chinese acquiring firms and how firms can mitigate any negative effect. Chinese culture emphasizes long-term orientation much more than Western cultures (Hofstede, Hofstede, & Minkov, 2010). That makes China a good context for such a study. Furthermore, China is representative in terms of its development level and the motivation for cross-border M&As (Luo & Tung, 2007). Such M&As have become popular in recent years, but Chinese acquirers are still at the initial stage of internationalization, similar to other emerging economies. This is a relatively new phenomenon which has not been extensively studied thus far (see several recent exceptions by Gubbi et al., 2010; Lin, Peng, Yang, & Sun, 2009; Ning et al., 2014; Yang, Sun, Lin, & Peng, 2011). This study therefore contributes to this new research area, and the practical implications of its findings are discussed in the final section of this paper.

2. Theoretical background

2.1. Cross-border M&As

Mergers and acquisitions are an important entry strategy for foreign direct investment, and they are normally motivated by the same strategic considerations and potential benefits that drive other foreign direct investment decisions, e.g., to better exploit a firm's assets, to strategically enhance its competitive advantages and to diversify risk. Firms with superior assets may seek to expand their operations internationally to better utilize firm-specific assets such as superior products, technology, management skills, marketing channels, economies of scale or scope, better corporate governance, or even special government incentives (Bris & Cabolis, 2008; Errunza & Senbet, 1981). Such proprietary and intangible firm-specific assets can provide a foreign acquirer better profit potential than a local potential bidder for the same target (Bris & Cabolis, 2008; Dunning, 1988; Krugman, 1987; Martynova & Renneboog, 2008).

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