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Do innovative emerging market cross-border acquirers create more shareholder value? Evidence from India

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ABSTRACT

This study attempts to investigate the role of absorptive capacity of emerging market firms in creating shareholder value from developed market acquisitions. It analyzes the cumulative abnormal return of cross border acquisitions of listed Indian firms in Europe focusing on acquirers' research intensity. The study discovers a U-shaped relationship between research intensity of Indian acquirers and their cumulative abnormal return following acquisitions in Europe. As such, firms with no research capacity can benefit from the acquisition by accessing advanced targets, although firms with extensive research capacity outperform any of their Indian competitors as these firms have the absorptive capacity to not only exploit but also explore the knowledge base of the acquired target. Furthermore, we found a positive effect of the acquisition of a high-tech target company, regardless of the absorptive capacity of the acquirer. We also found that business group membership has a positive impact on shareholder value, although horizontal acquisitions as compared to vertical and unrelated deals have a significantly negative impact for these companies. This result is again linked to the more explorative nature of vertical and unrelated acquisitions in comparison with horizontal deals that are more based on the exploitation of existing resources and capabilities.

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1. Introduction

Emerging market firms (EMFs) do not seem to follow the path of incremental internationalization (Contractor, 2013), but expand much faster (Mathews & Zander, 2007). Multinationals from emerging economies invest overseas at a relatively earlier stage of their development than their counterparts from developed economies (UNCTAD, 2006). Not only do they expand much faster, they also increasingly do so in advanced economies by means of cross-border acquisitions (CBAs). This has resulted in a steep increase of acquisitions of EMFs in advanced economies (UNCTAD, 2006). Most FDI – in terms of value – by emerging market firms in developed economies occurs through acquisitions (Ramamurti & Singh, 2009). This resulted both in positive as well in negative reactions in advanced economies. On the positive side, acquisitions are praised by target companies as sources of capital and ways to tap the home economies of the emerging multinationals (Knoerich, 2010). On the negative side, acquisitions are seen as threats or as competition against which target company governments should act in a protectionist reflex.

Indeed, EMFs that acquire companies in developed economies go against the grain of conventional wisdom of extant international business theory (Mathews, 2006). Some authors argue that EMFs behave differently from AMFs (advanced market firms) and, thus, new theories and models are required to explain their behavior. EMFs seem to lack the technology, brand, or management advantages of AMFs. Madhok and Keyhani (2012) characterize EMFs as having only 'ordinary' resources, by which they mean resources that have traditionally not been considered to be the source of extraordinary rents as is the case, for instance, for technology or brand, which are argued to underpin non-location-bound firm-specific advantages (Ramamurti, 2012). EMFs' internationalization is seen as the result of exploiting home country comparative advantages, such as cheap labor or natural resources, not firm-specific ownership advantages (Rugman, 2008; Narula & Nguyen, 2011). They argue that EMFs do not possess the firm-specific advantages that are necessary in the early stage of their international growth to improve absorptive capacity and innovative capability (Rugman & Verbeke, 2003). EMFs are therefore rather said to internationalize to obtain the ownership advantages

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they lack (e.g., Mathews, 2006; Madhok & Keyhani, 2012). This argument is sometimes referred to as the 'springboard theory' of internationalization (Luo & Tung, 2007).

In essence, there is no consensus about the applicability of using traditional resource based models to explain the sources of competitive advantages for emerging market firms. This study attempts to shed some light on this debate, in trying to analyze whether emerging market firms can create value by cross-border acquisitions in advanced markets, and what some of the drivers of shareholder wealth creation are. In particular, this study examines the acquisition behavior of Indian firms in Europe.

Most research on resource dependency explanations of value creation of acquisitions are based on empirical analyses of samples in developed economies. It is interesting to see whether they also apply to emerging market firms. It might reflect that CBAs by firms from emerging economies are accompanied by different shareholder expectations and management perspectives than for firms in developed economies. In that respect, our study contributes to the growing stream of research on the determinants of successful inorganic modes of internationalization in the form of cross-border acquisitions by emerging economy multinationals (Deng & Yang, 2015).

In particular, we advance the understanding of the relationship between capability development through internal R&D and through acquisitions in advanced markets. Therefore, we want to find out whether the absorptive capacity of emerging economy acquirers as made explicit in their research capacity has a positive or negative influence on market responses to acquisitions. In doing so, we hope to be able to answer the question whether they can link, leverage and learn from these acquisitions without much absorptive capacity to speak off or whether they need sufficient absorptive capacity to do so. As such, we want to find out whether there is a negative or positive relationship between absorptive capacity of Indian companies and financial returns when acquiring companies in Europe.

We theorize that rather than being strictly complements or substitutes, the relationship between research capacity and financial return after an acquisition might be curvilinear. Indian companies with extensive research capacity themselves can be expected to learn from an acquisition by exploring and learning from the target's knowledge base (Grant & Baden-Fuller, 2004). Subsequently, we investigate whether acquirers that lack research capacity themselves can also benefit, not from exploring and learning from the target's knowledge base, but from exploiting the knowledge access to strategic assets and trying to apply the knowledge (Grant & Baden-Fuller, 2004).

The study therefore contributes to the literature as it tries to investigate whether there is scope to compare and combine the resource based view of the firm with the theoretical perspectives of organizational learning and the learning-leveraging-linking model (Mathews, 2006) to explain successful internationalization of the emerging market firms (Guillén & Garcia-Canal, 2009). Gubbi, Aulakh, Ray, Sarkar, and Chittoor (2010) provided evidence that acquisitions by dragon MNEs from India create abnormal value if the targeted companies are operating in more advanced economies as opposed to emerging economies. They attribute value creation by dragon MNEs to the institutional environment of the home base of the target company. Unlike their approach, this study goes beyond determining whether there is a difference between acquisitions in advanced versus emerging economies and attempts to investigate whether the absorptive capacity of dragon MNEs plays a part in the ability to create shareholder value from the target they acquire in developed markets. As such, this study attempts to open up the firm-level black-box and determine relevant emerging market firm-level characteristics and heterogeneity when acquiring companies in developed countries.

In the following sections, we first establish the theoretical background and draw hypotheses to find out how important absorptive capacity of the investing firms is in the estimated value creation of Indian CBAs in Europe. We then describe the data and the methodology, while the results are subsequently reported. The final section consists of the discussion and conclusions.

2. Theoretical background and hypotheses development

2.1. Emerging market firms acquiring advanced market firms

Acquisitions can be beneficial but challenging (Tuch & O'Sullivan, 2007), and cross-border acquisitions have additional benefits and challenges (Shimizu, Hitt, Vaidyanath, & Pisano, 2004). However, both in international business and strategy research, the performance of cross border acquisitions is not well received. Acquisitions in general do not seem to create above normal returns for the acquirers' shareholders (Bouwman, Fuller, & Nain, 2009; King, Dalton, Daily, & Covin, 2004; Sudarsanam, 2010).

So international expansion through acquisitions offers significant value-creation opportunities for firms; but it also presents significant challenges that jeopardize the potential hypothesized gains. In this context, various researchers highlight risks such as "liability of foreignness" and "double-layered acculturation" (Barkema, Bell, & Pennings, 1996; Eden & Miller, 2004). Such risks pertain to the differences in customer preferences, business practices, and institutional forces; and they are exacerbated impediments to the complete realization of strategic objectives.

Furthermore, lack of experience in the acquiring firm of executing acquisitions, organizational inertia in absorbing the target, and prior absence in the country of the target company may inhibit the benefits of acquisition for firm value. Additionally, complications in target assessment, misidentification of asset complementarities, informational asymmetries, and high premiums paid for the targets may also have adverse effects on the value of acquiring firms (Hitt, Ireland, Camp, & Sexton, 2001; Kissin & Herrera, 1990). Finally, managers' self-serving goals and incentives in value-reducing diversification strategies may not be entirely consistent with shareholder wealth creation (Denis, 2001). In the case of India, the more popular press sometimes sees the takeovers of European companies by Indian companies as a way for the former colonies to revenge against the former imperialist powers (Economist, 2007).

Although it is challenging for any firm to integrate and manage the target firm and extract value from an acquisition (Puranam & Srikanth, 2007; Zollo & Singh, 2004), EMFs may find it even more challenging because their managers lack the institutional resources and knowledge needed to operate in advanced countries.

The results of emerging market CBAs in developed economies are not conclusive in the current literature. For example, Gubbi et al. (2010) study CBAs by Indian multinationals between 2000 and 2007 and show that international acquisitions by Indian firms earn significantly positive value for their shareholders. Boateng, Qian, and Tianle (2008) study 27 cross-border acquisitions made by Chinese publicly-listed firms between 2000 and 2004 and find that cross-border M&As create value for Chinese acquiring firms. However, Chen and Young (2010) examine 39 Chinese CBAs between 2000 and 2008 and find that the Chinese acquiring firms with majority government ownership tend to destroy shareholder value. In addition, Aybar and Ficici (2009) examine CBA announcements made by 58 emerging-market multinationals during 1991–2004, and find that the equity markets react negatively to the emerging market CBA announcements.

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