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Emerging market MNE cross-border acquisition equity participation: The role of economic and knowledge distance

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ABSTRACT

We theorize that in an attempt to facilitate the transfer of tacit assets during cross-border acquisitions, Emerging Market Multinationals (EMNEs) pursue higher levels of equity participation when targets are based in locations that are institutionally distant in terms of knowledge protection and economic development. Furthermore, we propose that these direct relationships are stronger for EMNEs than they are for MNEs. We test these propositions by comparing the cross-border acquisition activity of firms based in BRIC countries versus the U.K. While we do find a positive linear relationship between knowledge distance and equity participation, the link with economic distance is curvilinear. We also find that both dimensions of distance have greater positive effects on equity participation for EMNEs in comparison. The key implications are that institutional distance may be a positive for EMNEs and that their behavior does seem significantly different than traditional MNEs. This offers support for EMNE-specific internationalization theories.

1. Introduction

Cross-border acquisitions have increased in frequency and value over the last 20 years, leading to an increase in research on the antecedents, moderators, and consequences of these decisions (Barkema & Schijven, 2008; Haleblian, Devers, McNamara, Carpenter, & Davison, 2009; Shimizu, Hitt, Vaidyanath, & Pisano, 2004). The growth of cross-border acquisitions has been fueled by industry consolidation, privatization, and the liberalization of economies around the world (Shimizu et al., 2004). A vast majority of this research has focused on cross-border acquisitions by firms based in developed countries. While this research is warranted and beneficial, the last two decades have also seen an increasing number of cross-border acquisitions initiated by Emerging Market Multinationals (EMNEs). In fact, emerging markets such as Brazil, Russia, India, and China have been a major source of cross-border acquisitions during the recent global recession and account for approximately 75% of all emerging market foreign direct investment (FDI) outflows (UNCTAD, 2013). As EMNE acquisition behavior becomes more prominent, it is important that we gain a fuller understanding of how the unique context of emerging markets spurs this type of internationalization, as well as to determine if and how EMNE acquisition behavior differs from more traditional developed country MNEs.

Acquisitions often fail to achieve value for acquirers, with implementation and integration difficulties often singled out for blame. Cross-border acquisitions are even more troublesome as institutional distance (i.e., the relative difference between institutional frameworks of the home and host country) reduces the compatibility of heterogeneous operating environments (Kostova, 1996, 1999; Kostova & Zaheer, 1999; Shimizu et al., 2004; Xu & Shenkar, 2002). Larger relative differences between two environments hinder a firm's ability to transfer strategic orientations and organizational practices from parent to subsidiary, thus decreasing the chance of successful integration (Kostova, 1999). Xu and Shenkar (2002) point to institutionally dissimilar contexts that make conflicting demands for external legitimacy (or local responsiveness) in the host country and internal consistency (or global integration) within the MNE system. Based on this logic, it is assumed that institutional distance is a deterrent when it

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comes to choosing acquisition targets. However, it has been suggested that institutional factors influence EMNE internationalization behavior differently (Peng, Sun, Pinkham, & Chen, 2009; Peng, Wang, & Jiang, 2008; Redding, 2005).

Recent scholarship suggests that institutional distance affects the level of equity taken in cross-border acquisitions (Malhotra, Sivakumar, & Zhu, 2011; Morschett, Schramm-Klein, & Swoboda, 2010; Richards, 2000). This equity level, often referred to as equity participation, reflects the size of ownership stake pursued in a given cross-border acquisition. While the entry mode literature has generally treated acquisitions dichotomously, i.e., as either full or partial, with the latter treated as a form of joint venture (Barkema & Vermeulen, 1998; Brouthers & Hennart, 2007; Das & Teng, 2000; Hennart, 1991; Inkpen, 2001), the actual share of equity acquired in cross-border acquisitions varies widely. As the degree of ownership taken in an acquisition impacts many aspects of a firm's strategy – such as control over the venture, ability to transfer tacit assets, and risk exposure (Chari & Chang, 2009; Das & Teng, 2000; Pisano, 1989) – perhaps a more nuanced approach is warranted.

This may be especially true when studying EMNEs, who many suggest are more aggressive, proactive, and risk-taking versus traditional MNEs when pursuing globally competitive strategic assets and capabilities via internationalization activity (Chen, 2011; Hope, Thomas, & Vyas, 2011; Luo & Tung, 2007; Mathews, 2002, 2006). We suggest that EMNEs are more likely to pursue higher equity participation with targets based in locations that are more economically developed and more protective of knowledge assets. They do this in order to gain greater control over the target and their assets. This is especially important with respect to the acquisition of intangible assets that often serve as the key motivation for acquisition, as greater control has been found to facilitate the transfer of tacit assets (Chari & Chang, 2009; Das & Teng, 2000).

In support of this assertion, we find that EMNEs do generally seek larger equity shares when acquiring targets in distant locations with higher levels of economic development and knowledge protection (e.g. intellectual property). When EMNE behavior is compared to a sample of cross-border acquisitions by MNEs based in the UK, knowledge distance is found to have a larger effect on EMNE equity share. With respect to economic distance, however, there is an inflection point. The relationship takes the form of an inverted U, with equity share sought increasing from low to moderate levels of economic distance, but then decreasing sharply as the level of economic distance becomes too large. Furthermore, economic distance has a significantly different effect on EMNE behavior than the UK MNEs.

These findings contribute to the limited existing research on EMNE cross-border acquisitions (Aybar & Ficici, 2009; Gubbi, Aulakh, Ray, Sarkar, & Chittoor, 2010; Hope et al., 2011) by furthering our understanding of this phenomenon, and in so doing extend research on EMNE internationalization behavior in general. Furthermore, it offers evidence of how these firms differ from more traditional MNEs, such as those based in the UK. Specifically, that for EMNEs the effect of "distance" may actually be positive in some cases, contrary to what is generally found for more traditional MNEs from the developed world (Shimizu et al., 2004).

In the coming sections we first highlight the relevant literatures on EMNE cross-border acquisitions, institutional distance, and equity participation. Through this discussion we build to the argument that greater economic and knowledge distance increases equity participation in EMNE cross-border acquisitions and why the effect of these variables may be different than for more traditional MNEs. We then discuss our methodology, findings, implications for theory and practice, and future directions for research.

2. EMNE cross-border acquisitions, institutional distance, and equity participation

Roughly 30% of all acquisitions are considered cross-border, and are growing in both the number of deals and value (UNCTAD, 2013). Emerging markets have been an increasing source of acquisitions, reflecting a broader internationalization behavior that is more aggressive relatively and defiant of traditional internationalization theory (Aybar & Ficici, 2009; Gubbi et al., 2010; Hope et al., 2011; Luo & Tung, 2007).

2.1. EMNE cross-border acquisition behavior

EMNEs are theoretically different from traditional MNEs in that their comparative advantage is based on their latecomer status (e.g., as a low cost partner, not seen as a legitimate threat by established MNEs, lack of legacy costs, organizational flexibility) and the idiosyncratic nature of their home country (e.g., preferential access to low-cost labor, capital, or government policy), as opposed to the firm-specific advantages on which traditional MNEs rely (Mathews, 2002, 2006; Ramamurti, 2009; Rugman, 2009). Furthermore, EMNEs use these comparative advantages in order to acquire the targeted knowledge and capabilities strategically necessary to develop the firm-specific advantages that will help them become and remain globally competitive (Kedia, Gaffney, & Clampit, 2012).

Luo and Tung (2007) propose that EMNEs will systematically and recursively use international expansion as a springboard to acquire critical resources needed to compete more effectively against rivals (both at home and abroad), and to avoid institutional and market constraints (at home). EMNE internationalization behavior is systematic in that steps are deliberately designed to facilitate firm growth and to ultimately establish a competitive position in the global marketplace. It is recursive in that activities are recurrent (e.g., one foreign acquisition may improve an EMNE's disadvantage in managerial expertise, while a later acquisition might aim to improve logistics networks in the host country) and revolving (i.e. outward activities are strongly integrated with activities back home). EMNEs will also try to overcome their latecomer disadvantage through aggressive, proactive, and risk-taking acquisitions. Furthermore, EMNEs are motivated to internationalize because they seek both strategic assets (e.g. technology, R&D operations, operational know-how, and managerial expertise) and the opportunity to bolster economic and social development at home, and in so doing recompense for firm level competitive disadvantages globally (Gaffney, Kedia, & Clampit, 2013).

In recent years, an increasing portion of cross-border acquisitions are being initiated by EMNEs. In fact, in 2007 EMNE's share of cross-border acquisitions by value and number of deals has grown to 13% and 17% of total global acquisitions, respectively, up from roughly 4% and 5%, respectively in the late 1980s (Hope et al., 2011). This trajectory continues, as cross-border mergers and acquisitions grew 120.8% in emerging markets from 2012 to 2013 (UNCTAD, 2013). This is an interesting phenomenon in light of the fact that EMNE acquisitions have been shown to be even less successful than the cross border acquisitions of their traditional counterpart MNEs (Aybar & Ficici, 2009). Although there is limited research to explain this, a few notable exceptions exist; Hope et al. (2011) found, on average, EMNEs (compared with developed country MNEs) bid higher to acquire assets in developed countries when national pride is a motivation. However, Gubbi et al. (2010) found that in the case of Indian firms, cross-border acquisitions actually created value, especially when investments were made in developed countries.

Building on these and similar extant research, there is still a need to further explore whether EMNE cross-border acquisitions are truly more aggressive and have other behavioral differences