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High-tech firms' international acquisition performance: The influence of host country property rights protection

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ABSTRACT

Prior research suggests that high-tech firms tend to encounter market transaction uncertainties in countries with weak property rights protection (PRP) and that transaction costs will increase significantly with such uncertainties. Basing our study on high-tech firms that have recently been increasingly acquiring targets in these countries, we explain this puzzling phenomenon. In particular, we investigate whether and how high-tech firms can gain value from acquiring targets in host countries with different degrees of PRP. In addition to transaction costs, we take into account market demands for advanced technologies in weak PRP host countries and fierce market competition in strong ones. Overall, we suggest that high-tech firms are likely to increase their performance by acquiring targets in weak PRP host countries where profit-generating opportunities tend to be more frequent than in strong PRP ones. Our theory receives strong empirical support from multilevel analyses of a sample of U.S. information technology (IT) firms' international acquisitions between 1995 and 2004. We also found that firms differ in their capabilities in gaining value in various levels of PRP host countries. When acquirer size increases, acquirers become less able to gain value through acquisitions in host countries with weak PRP; yet when acquirer host country acquisition experience increases, they are more able to gain value through acquisitions in host countries with weak PRP.

1. Introduction

The characteristics of high-tech industries – substantial initial investments and few later-stage costs – make it efficient for high-tech firms to exploit opportunities globally (Mulligan & Leary, 2009). U.S. high-tech firms have been actively expanding into western European markets through acquisitions where property rights protection (PRP) is similarly as strong as in their home country (Chari, Ouimet, & Tesar, 2010; OECD, 2003; Papageorgiadis, Cross, & Alexiou, 2013; Park & Choi, 2014; Tsang & Yip, 2007). Strong protection of firm-specific assets in Western Europe ensures that U.S. high-tech firms are able to sustain their profit-making capabilities based on their possession of core advanced technologies.

High-tech firms have serious concerns about weak PRP in developing countries; this is largely because they are likely to encounter knowledge leakage there and thus shorten their time horizon of capitalizing on their core technologies (Allred & Park, 2007; Falvey, Foster, & Greenaway, 2006; Hart & Moore, 1990; Henisz, 2000; Jain, 2002; Maskus, 2000; OECD, 2009; Peng, 2001, 2004; Williamson, 1975). However, in recent decades high-tech firms have been increasingly investing in these countries through acquisitions of local targets (OECD, 2009). Acquisitions of the controlling rights (more than 50% shares) of local targets can help to internalize the opportunism of local partners (e.g., knowledge leakage) and thus decrease the risks and costs of exploiting their core technologies in local markets (Papageorgiadis et al., 2013). Yet, such internalization is not able to completely reduce uncertainties and risks in such weak PRP environments where external market transactions with local important stakeholders such as competitors, consumers and suppliers are embedded.

It is thus puzzling whether and how high-tech firms gain value from acquisitions of targets in weak PRP countries, particularly compared with those in strong PRP ones. The answer to this research question has important theoretical and practical implications for managers who intend to expand their markets to developing countries with weak PRP through acquisitions.

In our view, prior research has paid salient attention towards the external market transaction uncertainties and opportunism caused by weak PRP (Chan, Isobe, & Makino, 2008; Meyer, Estrin,

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Bhaumik, & Peng, 2009). These arguments provide us with a partial understanding of post-acquisition value creation in host countries with various levels of PRP. As an old saying goes, every coin has two sides. Because weak PRP inhibits innovation and technological development (DiMaggio & Powell, 1983; North, 1990; Tsang & Yip, 2007), huge market opportunities for advanced technologies are available in these countries (Chari et al., 2010; Tsang & Yip, 2007). In particular, global competition is nowadays based more heavily on technological developments. Yet, prior research has de-emphasized the tremendous market opportunities for high-tech firms in these markets. Comparatively, such market opportunities for advanced technologies are limited in host countries with strong PRP where technologically competent firms have been fiercely competing for market shares.

Further, whether high-tech firms can gain value in host countries with a mixture of uncertainties and market opportunities depends on their effective integration with local targets (Heimeriks, Schijven, & Gates, 2012; Paruchuri, Nerkar, & Hambrick, 2006). Acquisition scholars and managers have emphasized that integration is a key factor for acquirers to gain value from acquisitions of targets in host countries, and yet it is very challenging to achieve (Heimeriks et al., 2012; Paruchuri et al., 2006). Acquirers gain the controlling rights over targets through acquisitions and thus decide post-acquisition integration processes. Yet, targets that lose the battle to acquirers often do not passively collaborating with them and implement the integration but are very likely to resist it (Brockner, Grover, Reed, DeWitt, & O'Malley, 1987). Building on resource dependence theory (RDT), the unit that depends on the other unit within a firm for critical resources tends to be collaborative with the resource provider (Hillman, Withers, & Collins, 2009; Pfeffer & Salancik, 1978; Wry, Cobb, & Aldrich, 2013). Often targets – largely the ones in weak PRP environments – lack, and thus desire to possess, advanced technologies in order to survive and gain profits in local markets. Hence, these targets are more willing to collaborate and integrate with acquirers after acquisitions (Hillman et al., 2009; Pfeffer & Salancik, 1978; Wry et al., 2013).

Simultaneously taking into account uncertainties and market opportunities, and effective post-acquisition integration with targets in host countries with various levels of PRP, we thus expect that high-tech firms are likely to gain more value through acquiring targets in host countries with weak PRP than in strong ones. Furthermore, we suggest that acquirers differ in their capabilities in gaining value from acquisitions. We examine that both acquirer size and host-country acquisition experience are the moderators (Barnett & McKendrick, 2004; Capron & Guillén, 2009; Hayward, 2002). Our theoretical model is shown in Fig. 1.

We used a sample of U.S. firms' international acquisitions in the IT industry between 1995 and 2004 to test our theory; this is because the IT industry represents one of the most rapidly changing high-tech industries. Our theory receives strong support. The major contribution of this study is on four fronts. Firstly, we provide a comprehensive and clear understanding of how PRP in host countries affects high-tech firms' post-acquisition performance. Secondly, we contribute to the acquisition literature by enhancing our understanding of international acquisition performance from an institutional perspective (Capron & Guillén, 2009); and to institutional theory by adding to the knowledge of how PRP in host countries plays a role in the context of international acquisitions. Thirdly, we adopt multilevel analyses to answer our research question. Multilevel analyses that account for the non-independence of organizations within the same institutional environments are appropriate and they clearly show the effects of country-level institutions on embedded organizations (Hox, 2002). Lastly, heeding the call for advancing interdisciplinary research in international business (Cheng, Birkinshaw, Lessard, & Thomas, 2012), we show that interdisciplinary study which integrates the research of institutions, strategic management, and international business is imperative and relevant to advancing our understanding of global organizations – the dominant organizational form in this era.

2. Theoretical base

Neo-institutional and RDT provide strong theoretical foundations upon which we can develop our hypotheses. Neo-institutional theory explains how various levels of PRP in host countries influence transaction costs and market opportunities which the high-tech acquirers tend to incur and access after acquisitions. Such costs and opportunities influence the amount of profits which high-tech firms are likely to make after acquisitions. RDT theorizes the internal dependence relationship between acquirers and targets in post-acquisition combined firms (Brockner et al., 1987), and this influences the effective integration between the acquiring and the acquired firms.

2.1. Neo-institutional theory and PRP

Neo-institutional research suggests that *stronger* PRP tends to motivate embedded firms' investment in risky new technological development through setting higher pay-offs (Aguilera & Jackson, 2003; North, 1990; Redding, 2005). Firms in these countries, such as in the U.S.A., usually develop strong technological and innovative capabilities (Claessens & Laeven, 2003; North, 1990). In contrast, in weak PRP countries, firms are not able to ensure that they can gain proportionally from their investments in innovations (Chan et al., 2008; Meyer et al., 2009); this is because these gains are likely to be expropriated. Research found investment activities in industries that rely on intangible assets are disproportionately lower in countries with weaker PRP (Claessens & Laeven, 2003). Technological and innovation infrastructures in these countries are also weak in supporting technological development.

Nowadays the global competitive base is increasingly changing to technological development and innovation. Firms in weak PRP countries are likely to be forced to exit from the market if they do not develop their technological bases and upgrade their technological

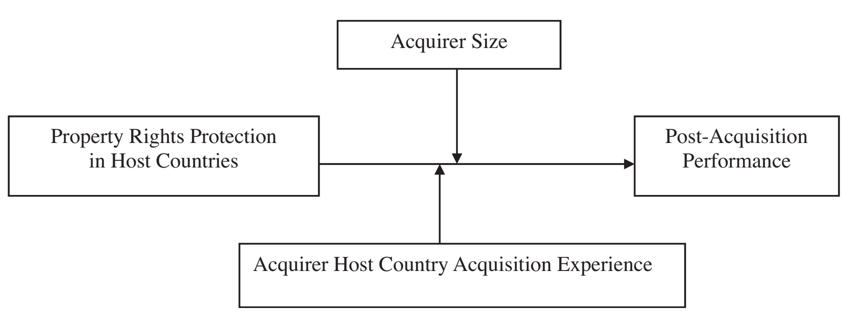

Fig. 1. Theoretical model.