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When history matters: The effect of historical ties on the relationship between institutional distance and shares acquired[☆]

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ABSTRACT

The share of equity foreign acquirers obtain in targets is relevant to important aspects of firm strategy. Drawing on institutional theory, we examine the impact of regulatory institutional distance on foreign investors' choice of percentage of shares acquired in targets in the transition post-Soviet economies of the Caucasus and Central Asia. In addition, we explore the moderating role of historical ties between the acquirer and target nations on the proposed relationship. Our sample consists of 150 cross-border acquisitions completed between 1999 and 2011 by acquirers from 30 nations. Results show differential effects of different regulatory institutional distance dimensions on the percentage of shares acquired. Furthermore, findings confirm that differences exist in acquirer preferences based on whether their country of origin shares historical ties with the target nation. The study provides new insights into the important role of history to foreign investment decisions.

1. Introduction

The share of equity foreign acquirers obtain in targets is relevant to important aspects of their firm's strategy, such as resource commitment, risk exposure, return, control over the venture, and ultimately, its survival (Anderson & Gatignon, 1986; Chari & Chang, 2009; Demirbag, Glaister, & Tatoglu, 2007). In the entry mode literature, the determinants of the extent of ownership of foreign firms in joint ventures (JVs) have received much research attention (Luo, 2001; Pan, 1996, 2002). We know much less about the determinants of the choice of equity share in CBAs (Arslan & Larimo, 2012; Chari & Chang, 2009).

The entry mode literature generally distinguishes between two forms of acquisitions (i.e., partial and full). An acquisition involving the purchase of 100% equity is referred to as full, while a purchase of less than 100% equity is referred to as partial acquisition (Barkema & Vermeulen, 1998). Partial acquisitions share similar features with joint ventures (e.g., shared ownership) and with acquisitions (e.g., the takeover of an existing organization) (Duarte & Garcia-Canal, 2004), however, this form of market entry has its unique advantages and disadvantages that need to be explored (Jakobsen & Meyer, 2008).

Few studies have examined the choice of partial acquisitions in transition and emerging economies (Demirbag et al., 2007; Jakobsen & Meyer, 2008). Herein, we differ from prior research by identifying factors that explain variation in share of equity obtained in targets in the economies of Caucasus and Central Asia rather than in determining the likelihood of a full versus partial acquisitions. The proposed conceptual model is depicted in Fig. 1.

We argue that (1) differences in regulatory institutions between acquirer and target countries influence the percentage of shares acquired in local targets and (2) the influence of regulatory institutional distance on the percentage of shares acquired defers based on whether historical ties exist between the acquirer and target nations.

Researchers have largely agreed that institutions do matter (North, 1990; Scott, 1995) and the focus has been redirected toward finding out "how" they matter, "under what circumstances, to what extent, and in what ways" (Powell, 1996: 297) do institutions influence strategic choice (Peng, 2003; Peng, Wang, & Jiang, 2008). Acquisitions of targets in transition economies are an especially appropriate context for the study of the influence of differences in regulatory institutions on the percentage of shares

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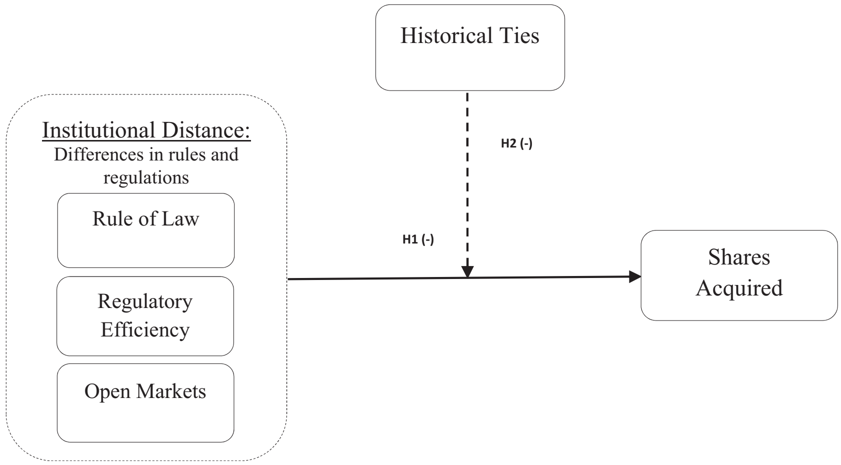

Fig. 1. Institutional influences on the share of equity in CBAs.

acquired. While regulatory institutions in developed economies tend to be well established and efficient in that they facilitate economic exchange, institutions in transition economies are still lagging behind (Meyer, 2001). As a result, these economies represent more uncertain, and therefore, riskier markets, where ownership level considerations are particularly relevant (Barkema & Vermeulen, 1998). Prior research has mainly focused on Central and Eastern European markets and none, to the best of our knowledge, has explored this phenomenon in the context of post-Soviet economies of the Caucasus and Central Asia (i.e., Armenia, Azerbaijan, Georgia, Kazakhstan, Kyrgyzstan, Turkmenistan, Tajikistan, and Uzbekistan).

These economies provide an interesting research setting for our study and are especially relevant to the study of extent of ownership in CBAs. On the one hand, these markets are attractive to foreign investors due to their natural resource endowments. On the other hand, these markets are characterized by high risk and uncertainty due to weak and inefficient regulatory institutions (Meyer, 2001; Meyer & Peng, 2005). Furthermore, the historical ties among the former Soviet republics and Russia are likely to play an important role in determining the share of equity foreign investors from these countries acquire in targets in the economies of the Caucasus and Central Asia, since they have similar institutional structures, legal systems, and business practices, which facilitate inter-country investment (Lundan & Jones, 2001). Research has shown that historical ties do matter for decisions regarding FDI timing and location (Makino & Tsang, 2011). Herein, we explore the moderating role of historical ties between the acquirer and the target nations on the relationship between institutional distance and the percentage of shares acquired in CBAs.

Overall, this article makes three contributions. First, we depart from prior research on the choice of ownership in CBAs in that we are interested in identifying the factors that explain variation in the percentage of shares acquired in foreign targets rather than in determining the likelihood of a full versus partial (i.e., minority or majority) acquisitions. Second, we contribute to the literature on the institution-based view by examining how differences in regulatory institutions between the acquirer and target countries influence the percentage of shares acquired in CBAs. More importantly, our analysis allows us to examine whether differences exist in terms of the effect of different dimensions of regulatory institutions on the share of equity obtained in targets. Lastly, we extend prior research by examining how shared history of being under common rule in conjunction with institutional distance influences the percentage of shares obtained.

We test the proposed relationships with a sample of 150 CBAs of targets in the countries of the Caucasus and Central Asia, completed between 1999 and 2011. The sample includes acquirers from variety of countries (i.e., countries which share historical ties with the sample of target nations and countries which do not). This allows us to evaluate the effect of acquirer's country of origin on the relationship between institutional distance and shares acquired in CBAs.

The paper is structured as follows. In the following section we review prior research on foreign direct investment (FDI) ownership strategies and the role of institutions. Next, we provide background information on the economies of the Caucasus and Central Asia. Then, we theorize about the role of institutions in determining the percentage of shares acquired and the moderating role of historical ties. Subsequently, we describe the data, methods and variables used in the analysis. Lastly, we present our results, draw our conclusions and suggest directions for future research.

2. Literature review

2.1. Ownership strategies in CBAs

Firms willing to expand their operations abroad need to decide which foreign market to enter and what entry mode to use. The two main categories of entry firms use to access foreign markets include (1) non-equity modes, such as licensing and exporting and (2) equity modes, that is, foreign direct investment. The most common way to classify equity entry modes has been in terms of the degree of ownership in the foreign venture. While complete ownership modes include full acquisitions and wholly-owned subsidiaries, shared ownership modes include joint ventures, alliances, and partial acquisitions (Brouthers & Hennart, 2007). Decisions regarding ownership in foreign market ventures are important since they have implications for the firm's resource commitment, risk, organizational control (Chari & Chang, 2009), and performance (Brouthers, 2002; Brouthers, Brouthers, & Werner, 2003). Furthermore, such decisions have long-term consequences and need careful consideration because they are difficult to change later on (Pedersen, Petersen, & Benito, 2002).

Transaction cost economics (TCE), the resource-based view, institutional theory, and Dunning's OLI paradigm, have been the theories most commonly used to explain entry mode choice (Brouthers & Hennart, 2007). Extant literature suggests that shared and full ownership modes can be considered as two opposing poles on a continuum with implications for the firm's level of control, commitment of managerial and financial resources, and risk.