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Revisiting and reinforcing the Farmers Fox Theory: A study (test) of three cases of cross-border inbound acquisition transactions

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A B S T R A C T

This paper aims to revisit and reinforce the early development of *Farmers Fox Theory* (Reddy et al., 2014a) by analysing three cases in the cross-border inbound acquisitions stream. A qualitative case method is adopted to explore the findings from the sample cases, which are the Vodafone—Hutchison telecom deal, the Bharti Airtel—MTN broken telecom deal, and the Vedanta—Cairn India oil deal. We highlight discussions on organizational factors, due diligence issues, deal characteristics, and country-specific determinants. Importantly, we test various theories propounded in the economics and management literature, and establish an interdisciplinary setting to both redefine the theory and reframe the propositions. The study eventually suggests that government officials' erratic nature and the ruling political party's influence were found to be severe in foreign inward deals characterized by a higher bid value, a listed target company, cash payments, and stronger government control in the industry. The findings of this research not only help researchers in strategy and international business but also managers participating in cross-border negotiations.

1. Introduction

1.1. Theoretical underpinnings

From the lens of development economics theory, international organizations and economic researchers have classified the given economic condition into the two groups of developed and developing countries. While supporting this streak, scholars from sociology, political, and legal studies have improved the definition of the economy on the basis of regulatory governance and political institutions. The two approaches suggest that developed economies have better quality laws, regulations, and institutions, which results in rich economic performance. In contrast, developing economies are characterized by poor economic results, lower quality institutions, no significant expertise in public administration, highly corrupt government officials, erratic behaviour of institutions, and high political intervention. In this vein, Lucas (1990) postulated 'why capital does not flow from rich to poor countries' and suggested that the weak institutional environment is one of the important determinants of insufficient capital flows from rich to poor nations. We propose that this postulation represents an institutional dichotomous characteristic of a developing economy, which scholars coined the 'Lucas paradox' (Alfaro et al., 2008). Theoretically, a given country has two investment options to doing business in other countries, namely direct international investment and portfolio investment. The direct investment allows the investor to enter a foreign country through a greenfield investment and/or mergers and acquisitions. Alternative entry mode choices include exporting, franchising, and licensing, among others.

Through the 1985—1991 economic and institutional policy reforms, developing countries have improved their economic indicators, regulatory laws, and business culture, thereby attracting significant overseas investments in various industries. In other

Abbreviations: CCI, Competition Commission of India; FDI, foreign direct investment; FIPB, Foreign Investment Promotion Board; IMF, International Monetary Fund; M&A, merger and acquisition; MNC, multinational corporation; ONGC, Oil and Natural Gas Corporation Limited; RBI, Reserve Bank of India; SEBI, Securities and Exchange Board of India; TRAI, Telecom Regulatory Authority of India; UNCTAD, United Nations Conference on Trade and Development; WEF, World Economic Forum.

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words, significant financial and non-financial benefits have spread from developed to developing economies through overseas investment reforms. For instance, the benefits are seen in business models, education, management expertise, technology, culture, living standards, and so forth. Following the globalization and liberalization programmes, the distance between countries has shortened, markets have integrated, and communication costs have declined sharply, together leading to the closer integration of societies (Stiglitz, 2004). At the same time, multinational corporations (MNCs) from developed economies have increased their investments in developing countries through the preferred method of foreign market entry of mergers and acquisitions (M&A) [in addition to greenfield investments]. This method offers numerous benefits, ranging from ownership to location advantages, and attracts significant risks, especially economic, regulatory, and political shocks (Bris and Cabolis, 2008; Kiymaz, 2009; Meschi and Métais, 2006; Rossi and Volpin, 2004). For instance, the extant M&A research reported that 83% of deals failed to create shareholder value and 53% actually destroyed value (as cited in Marks and Mirvis, 2011:162). For international deals, the failure rate ranges from 45% to 67% (Mukherji et al., 2013). Yet, the world market for corporate control activities substantially improved during 1991–2012, particularly from the sixth merger wave starting in 2003 (Feito-Ruiz and Menéndez-Requejo, 2011). For example, the worldwide number of cross-border deals (deal value) increased at a massive growth rate of 241% (1360%), from 1582 (US$21.09 billion) in 1991 to 5400 (US$308.06 billion) in 2012. For the Asian market, sales in terms of number of deals (deal value) notably improved at a significant growth rate of 908% (1818%), from 79 (US$1.54 billion) in 1991 to 796 (US$29.48 billion) in 2012. Conversely, purchases in terms of number of deals (deal value) drastically increased at a considerable growth rate of 833% (3521%), from 82 (US$2.20 billion) in 1991 to 765 (US$79.78 billion) in 2012. However, the percentage of the value of cross-border deals arising from foreign direct investment (FDI) inflows for 1991–2012 grew at an average annual rate of 37% for worldwide countries and 13% for the Asian market (UNCTAD, 2013).

Herewith, we postulate that cross-border inward investments declined at a shocking rate for both the Asian and the Indian market, whereas outward investments massively increased given lower asset valuations in developed markets and to escape from home country institutional barriers (Reddy et al., 2014b; Witt and Lewin, 2007). In addition to mounting overseas acquisitions in emerging markets, we notice that inbound and outbound deals are often litigated or are induced by institutional shocks in the host country when they are characterized by higher valuation, cash payments, and strong government control over the industry. For instance, Zhang et al. (2011:226) reported that 68.7% of worldwide acquisition attempts were completed during 1982–2009, of which 210,183 deals were not completed (460,710 deals completed) out of 670,893 acquisition events. Thus, this paper intends to analyse those litigated inbound deals associated with the Asian emerging market of India.

Extant international business (IB) and finance studies found that a country's constitutional framework, political and legal environment, bilateral trade relations, and culture play an important role in cross-border trade and investment deals for both ex-ante and ex-post performance. For example, Alguacil et al. (2011), Barbopoulos et al. (2012), Bris and Cabolis (2008), Erel et al. (2012), Francis et al. (2008), di Giovanni (2005), Huizinga and Voget (2009), Hur et al. (2011), and Rossi and Volpin (2004) suggested that legal infrastructure, corporate governance practices, financial markets development, the level of investor protection, the quality of accounting and reporting standards, and socio-cultural factors are the key determinants that affect the completion of cross-border M&A. Further, macroeconomic factors, including gross domestic product, the tax system and tax incentives, the exchange rate, and the inflation rate, have a significant impact on overseas acquisitions (Blonigen, 1997; Hebous et al., 2011; Pablo, 2009; Scholes and Wolfson, 1990; Uddin and Boateng, 2011). Moskalev (2010) found that a number of overseas investment projects significantly improved with respect to the progress made by a host country's legal enforcement of foreign investors. Importantly, local political events including general elections affect both inbound and outbound FDI flows (Ezeoha and Ogamba, 2010; Schöllhammer and Nigh, 1984, 1986), and physical distance affects foreign investments (Rose, 2000). Overall, value-creating strategies, such as mergers, acquisitions, and strategic joint ventures, promote corporate governance and institutional development (Alba et al., 2009; Martynova and Renneboog, 2008b).

With these prior studies in mind, we examine cross-border inbound acquisitions to the emerging country of India through a legitimate method of qualitative research, that is, case study research. Thus, we engage in a deep investigation into why cross-border inbound deals in India are frequently litigated. Before we explain the research framework, we present the factors that determine the success of cross-border M&As. Existing literature on cross-border M&A transactions suggests that firm-specific, deal-specific, and country-specific determinants influence both the negotiation process and post-merger integration. Then, we conduct the research and draw conclusions for the following broad research inquiry: how do host country characteristics affect the completion of international acquisition? Altogether, we attempt to revisit and reinforce the Farmers Fox Theory through an in-depth analysis (test) of three cases of cross-border inbound deals. Prior development of this theory was primarily propounded on the basis of evidence from a single case and inadequate testing of the theory (Reddy et al., 2014a).

The remainder of this paper is organized as follows. The balance of Section 1 presents the research motivation, the research question, objectives, and scope and contribution. Section 2 describes the research design with a special emphasis on the multiple case study method. Section 3 discusses key insights drawn from the cross-case analysis. Section 4 describes testing the theory and the case proofs. Section 5 outlines the major research task, which is to revisit and reinforce the Farmers Fox Theory. Section 6 concludes this study.

1.2. Research motivation

A significant number of previous studies examined cross-border acquisitions through the lens of finance, economics, and strategic management, whereas a small number of studies investigated M&A in the IB field. By and large, academic and industry researchers analysed stock returns around the announcement, post-merger operating performance, and integration determinants. These studies inferred that on-going scholars have significant scope for studying pre-merger negotiations, determinants of deal completion, and the influence of host country institutional attributes. Indeed, seven tracks that appeared in the cross-border M&A stream motivated us to pursue this research. At the outset, foreign market entry choices are an important research focus in the IB and strategy fields (Chapman, 2003; Hopkins, 1999). First, cross-border M&A largely remains underexplored compared with domestic M&A, and more theoretical and empirical research is needed to improve the current state of the literature (Bertrand and Betschinger, 2012; Hur et al., 2011; Shimizu et al., 2004). Second, inadequate research exists on deal completion that enables the study of factors affecting the success of cross-border inbound acquisitions (Ahammad and Glaister, 2013; Reis et al., 2013; Zhang et al., 2011). Third, most of the existing literature was built on the developed economies