



Cross-border mergers and strategic alliances

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ABSTRACT

This paper develops a model with distribution costs to study firm cooperation in forming strategic alliances and mergers, under different types of foreign market entry modes, that is, export or foreign direct investment (FDI). Under both export and FDI, we find that cross-border alliances (mergers) dominate domestic alliances (mergers); and cross-border alliances and mergers are preferred to independence if and only if distribution cost is high. Under export, cross-border alliances are chosen in equilibrium if distribution cost is high. Under FDI and with high distribution cost, cross-border alliances (mergers) are chosen in equilibrium if plant setup cost is low (high).

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1. Introduction

In the past two decades we have witnessed the acceleration of globalization. Globalization takes various forms as it penetrates countries. Beyond the traditional forms, namely export and green-field foreign direct investment (FDI), it has become common nowadays for multinationals to use cross-border mergers and acquisitions (M&As) or to form cross-border strategic alliances in order to extend their businesses internationally (OECD, 2001). The value of cross-border M&As grew from USD 153 billion in 1990 to USD 1 trillion in 2000, while the number of new cross-border strategic alliances increased from around 830 in 1989 to 4520 in 1999.¹ The Daimler–Chrysler merger, the Ford–Mazda alliance, and the Renault–Nissan alliance are just a few examples of this new trend of globalization occurring in the automobile industry. As pointed out in the OECD (2001), cross-border M&As and strategic alliances are two distinctive features of the recent industrial globalization.

Why do firms form cross-border strategic alliances or engage in cross-border mergers? What economic factors affect their incentives to form such alliances and mergers? To answer these questions, we build a two-country, multi-firm economic model, in which firms decide on the type of cooperation, namely, cross-border strategic alliances or mergers, given that they have made their individual choice in foreign market entry modes, that is, export or FDI.

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¹ See the OECD (2001) which is based on Thomson Financial's database and on the Japan External Trade Organisation (JETRO).

Firms form strategic alliances in order to cooperate in some aspects of their business. They are often competitors in the product markets. This type of partial cooperation is in fact a common feature among most strategic alliances.² Specifically, we assume that within the same alliance, the firms share their distribution networks; thus it is basically a distribution alliance. The Haier–Sampo strategic alliance is just a good example.³ Based on such a model, our analysis yields a number of important and empirically testable results. We find that cross-border alliances (mergers) dominate domestic alliance (mergers). A firm has a larger incentive to form a cross-border alliance or engage in a cross-border merger when distribution costs are high. In the case of FDI, the choice between cross-border alliances and mergers depends on the magnitude of FDI plant setup cost: lower plant setup cost associated with more alliances. Cross-border alliances (mergers) are strategically complementary; that is, a group of firms have a larger incentive to form an alliance (engage in a merger) when other rival firms also form alliances (engage in mergers). This last finding is consistent with the observation that cross-border alliances and mergers occur in waves.

This paper contributes to both the industrial organization literature and the international trade and FDI literature. With regard to the industrial organization literature on firm cooperation, such as joint venture and strategic alliances, studies include Cabral (2000), Chen and Ross (2000), Eerola and Maattanen (2004), and Morasch (2000). Like those studies, our paper also examines the incentives for forming strategic alliances. However, while those studies emphasize the alliances' implications on entry and product market competition, in contrast, we are more interested in firms' choice between strategic alliances and mergers, and comparing alliance incentives under different modes of foreign market entry.

While there exists no systematic study on cross-border strategic alliances, our paper is related to the small but growing body of studies on cross-border mergers in the literature of international trade and FDI. Most of these studies are concerned with the implications of trade liberalization on the profitability of cross-border mergers,⁴ the rationales for the emergence of cross-border mergers,⁵ and the various effects of cross-border mergers.⁶ However, the present paper has a different focus: it examines the choice between cross-border strategic alliances and cross-border mergers under various types of foreign market entry modes (i.e., export and FDI).

Nocke and Yeaple (2007) have also stressed the important role played by the marketing and distribution costs in affecting a firm's foreign market entry mode. In their paper, cross-border M&A is introduced as one of the three entry modes, along with greenfield-FDI and export. In contrast, cross-border strategic alliances and mergers in our model are a type of cross-border cooperation that the firms decide after they have chosen their foreign market entry modes, that is, export and FDI (greenfield).⁷ Moreover, in light of the observations that many large firms are engaging in cross-border strategic alliances and mergers (OECD, 2001), our model focuses on oligopolistic markets, similar to Horstmann and Markusen's (1992) model but in contrast to Nocke and Yeaple's (2007) model, which assumes monopolistic competition.⁸ As a result, market power and strategic interaction are present in our model, but not in those with monopolistic competition.

The rest of this paper is organized as follows. Section 2 presents the model. Sections 3 and 4 analyze the firms' cooperation decisions under export and FDI, respectively. Section 5 concludes the paper.

2. Model

Consider an industry in two identical countries, A and B. Assume that there are only two firms in each country: firms 1 and 2 in A, and firms 3 and 4 in B. All firms have the same production technology, and they produce differentiated products for both markets. Assume linear demand in each market and the two markets being segmented. Specifically, let x_{ik} be the demand and p_{ik} the price in market $k \in \{A, B\}$ for the goods produced by firm $i \in \mathcal{I} \equiv \{1, 2, 3, 4\}$, and let the inverse demand

² The OECD (2001) finds that strategic alliances often involve rival firms and are an instrument for combining co-operation and competition in corporate strategies.

According to Yoshino (1995), strategic alliances have the following three characteristics: (1) a few firms that unite to pursue a set of assented goals remain independent after the formation of the alliance (e.g., the independent export-FDI strategies and production decisions in our model); (2) the partner firms share the benefits of the alliance and the control of the performance of assigned tasks (e.g., the reduction of distribution costs in our model); and (3) the partner firms contribute on a continuing basis to one or more key strategic areas (e.g., marketing and distribution in our model).

³ Haier is a leading electronic appliance maker in the Chinese Mainland, and Sampo is a leading electronic appliance maker in Taiwan. On February 20, 2002, they signed a strategic alliance agreement to market each other's products in their domestic markets (People's Daily, February 25, 2002).

⁴ E.g., Long and Voutsden (1995).

⁵ E.g., Horn and Persson (2001) on trade costs, Lommerud et al. (2006) on plant-specific unions in oligopolistic competition, Neary (2007) on international difference in technologies, and Qiu and Zhou (2006) on information sharing.

⁶ E.g., Head and Ries (1997), Chen (2004), and Qiu and Zhou (2006) on competition and welfare, and Neary (2007) on trade pattern and income distribution.

⁷ Strategic alliances per se are not a means of foreign entry. They help their firms to enter foreign markets via exports or FDI. It has been observed that "many auto makers are forming and strengthening alliances with Japanese car makers in order to penetrate fast-growing Asian markets" (OECD, 2001, p. 86).

⁸ There are two sets of evidence that support our choice of the industrial organization approach (i.e., focusing on oligopolistic markets and strategic interactions). First, as pointed out by the OECD (2001), recent studies of multinationals outline that large-scale, cross-border M&As and strategic alliances take place because large firms need to adapt to a changing global environment. Thus, cross-border M&As tend to reflect an economic and industrial rationale based principally on size advantages, which have been amplified by recent institutional, technological, and organizational changes. Second, governments strengthen their competition policies precisely because they worry about the resulting increased market power after M&As and strategic alliances are formed.

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