



# Uncertainty avoiding behavior and cross-border acquisitions in the Asia-Pacific region<sup>☆</sup>



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## ABSTRACT

This research explores the impact of national culture on cross-border acquisitions. National culture can influence the ways managers cope with uncertainty, and their subsequent business decisions, as was described in seminal research by Hofstede (1991). By their very nature, cross-border acquisitions require that managers deal with different cultures and higher levels of uncertainty. We seek to understand how national culture affects value in cross-border acquisitions using data from the Asia-Pacific Rim region over the period between 2000 and 2009. The countries of this region have large cultural differences and the potential gains from acquisitions are very substantial, so these data are an excellent population for analysis. Our results show that different national cultures have an important influence on financial decisions by firms in ways consistent with classic research by Knight (2006), and also that different national cultures cope with uncertainty in different ways. We find that acquirers from countries with a high aversion to uncertainty conduct fewer cross-border acquisitions. Further, these high uncertainty aversion firms pay a higher price for control in cross-border deals.

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## 1. Introduction

This research explores the impact of national culture on cross-border mergers and acquisitions. Culture can influence the ways managers cope with uncertainty, as was described in seminal research by Hofstede (1991). Culture can affect firm value through at least two channels. The first channel is indirect: culture in concert with history will influence corporate governance, especially through its impact on laws. A number of studies have examined the link between corporate governance and firm value

(La Porta et al., 2000; Gompers et al., 2003; Starks and Wei, 2013).<sup>1</sup>

In general, the research concludes that the quality of corporate governance does affect firm value. Culture's second channel arises from the way it influences management decisions. Chui et al. (2002) was one of the first studies of the impact of culture on financial decisions; they examined culture's influence on capital structure. Since then, a substantial volume of research deals with the impact of national culture on financial outcomes and financial decision making (e.g., Tihanyi et al., 2005; Siegel et al., 2011; Zheng et al., 2012; Shao et al., 2013; Karolyi 2015a,b, with more research described in Section 2). Our research is an exploration of this second channel through an examination of cross-border acquisitions while controlling for the influence of the first channel. By their very nature, cross-border deals require that managers contend with different cultures and higher levels of uncertainty. We seek to understand how culture affects financial decision-making in cross-border deals through empirical analysis.

Acquiring another firm requires estimates of the target firm's value, both in the sense of its worth as a subsidiary and in terms of a price acceptable to target firm shareholders. Of course these values will be connected; target firm shareholders will want some (all) of

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<sup>1</sup> These studies are part of a broader literature that links culture to economic outcomes. See Guiso et al. (2006).

the post-acquisition value. The key is the post-deal value; yet this value is uncertain. There is a real risk that the post-acquisition value will be low. Value might be low because the deal itself is flawed due to lack of information about the target or just because of plain bad luck. Value could also be low because residual management and ownership elements extract rents inefficiently, or undermine the acquiring firm's management efforts. This research argues that national culture, in particular the preference to avoid uncertainty, will influence the way the acquiring firm's management approaches these issues. Managers whose attitudes developed in a culture that seeks to avoid uncertainty will be more selective when acquiring targets that have greater uncertainty; when they do make acquisitions, they are likely to acquire a larger portion of the target's shares and pay a higher price for these targets. The higher price paid for a greater uncertainty target is not necessarily a result of overvaluation; it could result from the highly selective acquisition process that uncertainty-avoiding managers follow. The links between these acquisition issues and culture will be more apparent in cross-border acquisitions because the acquiring company has to deal with a target in a less familiar country.

To explore the link between culture and firm value, we develop testable hypotheses that explain how aspects of culture change the premium and acquisition details of both domestic and cross-border acquisitions. These hypotheses are developed in the context of Hofstede et al. (2010), who formulated indices of cultural tendencies for countries based on the dimensions of power distance, uncertainty avoidance, individualism and masculinity. Our main hypotheses relate to Hofstede's uncertainty avoidance index. Uncertainty avoidance is a measure of a society's tolerance for uncertainty. Uncertainty avoidance asserts that people from high uncertainty avoidance cultures will feel deeply uncomfortable in ambiguous situations. They will respond by attempting to avoid these situations or by reducing ambiguity by trying to control these situations. We suspect that managers of companies operating in countries with a culture that seeks to avoid uncertainty will be less likely to make foreign acquisitions because these have greater uncertainty. If this is the case, these firms will conduct cross-border acquisitions only when the potential gain is judged to be large enough relative to their own decision-making standard. In addition, once they do decide to seek the deal, they will attempt to avoid the uncertainty of completing the deal by paying higher control premiums. Further, after they complete the deal uncertainty avoiding managers will secure a higher level of control. We find that acquirers from countries with a high uncertainty avoidance index value do pay a higher price for control, but this is primarily the case for cross-border acquisitions; they do not pay more for domestic deals. This is consistent with our prediction because domestic deals have less uncertainty. Furthermore, we show that this cultural influence is different from the link between the legal protection of minority shareholders and firm value that has been established in the literature. Thus, our primary contribution is to document how culture influences financial decision-making in cross-border acquisitions.

We conduct our analysis using a large sample of cross-border acquisitions, but our main focus is on the diversity in attitudes toward uncertainty among countries in the Asia-Pacific Rim region. This region has grown at a much faster rate than the rest of the world and cross-border investment within the region has been, and will continue to be very substantial. Hence, these data are an excellent sample to test our hypotheses; the countries of the Asia-Pac Rim have close economic relationships with each other, yet have large cultural differences and the potential gains from acquisitions are very substantial. We expect that the huge differences in culture among countries in the Asia-Pac Rim region

will result in very different attitudes towards cross-border acquisitions.<sup>2</sup>

Our research is related to work by Frijns et al. (2013). They focus on how managerial risk tolerance at the national level impacts the expected synergies required for mergers to be conducted. They find that managers from countries with higher uncertainty avoidance behavior conduct fewer cross-border acquisitions and require higher expected synergies. Using data that partially overlap Frijns et al. (2013) we confirm their result that managers from higher uncertainty avoiding countries conduct fewer cross-border acquisitions. We show that these managers tend to pay higher premiums as well. Our research extends their work by examining a broader set of transactions over a more recent period. We examine majority and partial acquisitions; this permits a far more nuanced evaluation of how uncertainty avoiding behavior influences the proportion of ownership sought in domestic and cross-border acquisitions. By including partial acquisitions, which are not considered in previous research, we expand the size of the sample in the Asia-Pacific Rim region to permit a more thorough analysis as well as to better understand acquisitions that achieve control yet give minority owners potential influence in the post-acquisition entity.

In spirit, our research is also related to, but importantly different from Ahern et al. (2015) who examine the role of national cultural distance in corporate acquisitions. They find that cultural distance has significant effects on the volume and value of cross-border mergers. The volume of mergers is lower when countries are more culturally distant. Similarly, they find that the gains associated with the announcement of mergers are lower when there is a greater difference in cultural measures of trust and individualism between targets and acquirers. Our paper is different in that we do not focus on the cultural distance between acquirer and target nations. Instead we examine how the way acquirers feel about uncertainty impacts the acquisition itself. We show that uncertainty avoiding behavior changes how managers acquire in several ways: whether to acquire, how cross-border acquisitions are different from domestic acquisitions, how large a premium to pay and what proportion to acquire.

The paper is structured as follows. The next section fleshes out the link between uncertainty avoidance behavior and acquisitions. In Section 3 we develop our hypotheses. In Section 4 we describe our data and methodologies, as well as report summary descriptive statistics. In Section 5 we present the main results of our analyses. Section 6 provides additional analysis of shareholder returns for acquiring firms to examine if high uncertainty avoidance firms irrationally overpay for acquisitions. Section 7 concludes the paper.

## 2. The literature on how culture influences acquisitions

Although our focus is on national culture, it is natural to initially approach the determination of cross-border acquisition value from the perspective of corporate governance and investor protection. This is consistent with the established literature, and also provides a benchmark from which we can explore the marginal impact of culture on acquisition value. The broad goal is to understand how cross-border deals are different from domestic deals. Specifically,

<sup>2</sup> Our research is particularly relevant to Japanese companies because Hofstede et al. (2010) categorize Japan as having the national culture that is most strongly averse to uncertainty. Japan is a great contrast to Singapore whose culture is least averse to uncertainty. In the view of the increasing cross-border M&A activities of Japanese companies within the region, it is important for their managements to understand the potentially different attitudes between themselves and their counterparts when negotiating acquisitions. Indeed, we find that culture does affect cross-border deals, and this influence is especially notable for deals involving Japanese acquirers.

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