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National economic disparity and cross-border acquisition resolution

Mi-Hee Lim, Ji-Hwan Lee*

KAIST College of Business, Korea Advanced Institute of Science and Technology, 85 Hoegi-ro, Dongdaemun-gu, Seoul 130-722, South Korea

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ABSTRACT

This paper explores the effects of national economic disparity on the completion or abandonment of cross-border acquisitions by combining behavioral perspectives of risky decision making and theories of organizational learning. Using a sample of 2445 cross-border acquisitions announced between 1985 and 2008, we show that an acquisition is less likely to be completed when the acquirer is from a more developed country *vis-a-vis* the target than when the acquirer is from a less developed country. Furthermore, the higher the economic development level of the acquirer's country relative to that of the target, the less likely the deal is to be completed. We also find that the time elapsed between the acquisition announcement and completion dates is shorter as the economic development level of the acquirer's country relative to that of the target is higher.

1. Introduction

As the volume of mergers and acquisitions (M&As) has grown sharply over the last several decades, studies of these transactions have been actively conducted in the fields of management and finance (Haleblian, Devers, McNamara, Carpenter, & Davison, 2009; Porzio, 2015). Moreover, the acceleration of globalization after the first decade of the 21st century and the widespread use of cross-border acquisition as the most significant foreign direct investment (FDI) vehicle have spurred scholars to extend their attention to cross-border acquisitions (e.g., Di Giovanni, 2005; Dikova, Rao Sahib, & van Witteloostuijn, 2010; Very & Schweiger, 2001; Zander & Zander, 2010). Such attempts have formed an emerging and promising body of research in international business, which delves into the consequences of country-level differences.

However, most studies on acquisitions, regardless of the geographic context, have focused on completed deals, as scholars are primarily interested in the post-acquisition outcomes of the firms involved (Datta, Pinches, & Narayanan, 1992; King, Dalton, Daily, & Covin, 2004). However, the share of acquisitions abandoned after a public announcement amounts to as high as 25% (Holl & Kyriaziz, 1996), as the acquirer maintains rights to renegotiate and withdraw the offer after an announcement (Puranam, Powell, & Singh, 2006). Nonetheless, research on abandoned transactions is scarce. Recently, scholars have begun to investigate the factors behind persistence (i.e., completion) or withdrawal (i.e., abandonment) of acquisition deals by approaching them from various theoretical angles and levels of analyses. For instance, the national environment, such as institutional, political, or cultural conditions (e.g., Dikova et al., 2010; Popli, Akbar, Kumar, & Gaur, 2016; Zhang & He, 2014; Zhang, Zhou, & Ebbers, 2011), and firm characteristics, such as prior experience or strategic compatibility (e.g., Dikova et al., 2010; Meyer & Altenborg, 2008; Muehlfeld, Rao Sahib, & Van Witteloostuijn, 2012), are revealed as significant predictors of acquisition completion. Given the continuing spread of acquisitions across the world, especially in cross-border contexts (Bolger, 2014), we believe there is much left to explore in this phenomenon.

Several studies examine the impacts of national factors on organizational behaviors and performance in a cross-border acquisition context; for example, economic characteristics (Berry, Guillén, & Zhou, 2010; Di Giovanni, 2005; Tsang & Yip, 2007), political conditions (Zhang et al., 2011), institutions (Dikova et al., 2010; Pablo, 2009; Rossi & Volpin, 2004), and culture (Chakrabarti, Gupta-Mukherjee, & Jayaraman, 2009; Kogut & Singh, 1988; Morosini, Shane, & Singh, 1998; Popli et al., 2016) are suggested as important factors. Because one of the provocative inquiries in this stream of literature is the role of country differences in acquisitions, this paper seeks to explore the effects of national economic discrepancy on two consequences of cross-border acquisitions (Dikova et al., 2010): deal resolution (completion versus abandonment) and deal duration (time elapsed between announcement and completion).

* Corresponding author.
E-mail addresses: mich@business.kaist.ac.kr (M.-H. Lim), jihwanlee@business.kaist.ac.kr (J.-H. Lee).

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We confine our research to cases completed or abandoned *after* a public announcement (i.e., the acquisitions initiated and resolved entirely in private and those abandoned before a public announcement are not included in this research). Such a setting has several merits that allow us to apply and elaborate theoretical frames more clearly. First, unlike many acquisitions that feature multiple potential acquirers or candidates before a public announcement, transactions that are publically announced typically involve only one acquirer. Second, while it is difficult to determine which side (acquirer or target) actually has greater bargaining power in a deal before a public announcement, decisions regarding completion or abandonment after a public announcement are more likely to be determined by the acquirer. Third, as more information tends to become available after a public announcement, the parties involved—especially the acquirer—can more accurately evaluate the attractiveness and hazards of a deal, thus reducing the likelihood of misjudgment.

This paper employs behavioral perspectives of risky decision making, including prospect theory, because acquisition completion or abandonment is an outcome of risky decisions made by individuals (in this context, managers) (March & Shapira, 1987; Pablo, 1994). While the traditional decision criteria include expected return, on the positive side, and perceived risk, on the negative side, behavioral perspectives of risky decisions also address decision makers' manner and capabilities in risky situations that elaborate the behavioral nature of decision making. This paper is also based on theoretical developments in organizational learning (Bandura, 1977; March, 1991) showing that the accuracy and efficiency of acquisition deals are largely dependent on the capabilities of the acquirer. While, in reality, only a few firms might have prior experience in cross-border acquisitions, we account for the possibility of vicarious learning through peer firms in a given national and institutional environment.

Our empirical results from 2445 cross-border acquisitions announced during the 1985–2008 period reveal that the possibility and duration of acquisition completion can be explained by the national economic status of the firms involved. We find that a cross-border acquisition is less likely to be completed when the acquirer is from a more developed country relative to the target than when the acquirer is from a less developed country. Such a tendency becomes stronger as the national economic difference between the two parties grows. However, conditional on completing the acquisition, as the economic development level of the acquirer's country increases relative to the target's country, less time is required to complete the deal after a public announcement.

In the next section, we provide the theoretical background of our study and develop hypotheses regarding the probability of cross-border acquisition completion and the duration of the intermediary takeover process. Next, we describe our sample, measures, and analytical models. Then, we present and interpret the results of the empirical tests. Finally, we identify the implications of our findings and offer avenues for future research.

2. Theoretical background

2.1. Pre-acquisition process and abandonment

There are numerous decision steps in the acquisition process (Pablo, Sitkin, & Jemison, 1996; Very & Schweiger, 2001). Researchers often decompose the takeover process into the private and public phases, i.e., the phases before and after a public announcement (Boone & Mulherin, 2007; Dikova et al., 2010; Moeller, Schlingemann, & Stulz, 2004; Schwert, 1996). The private takeover process generally begins when a selling firm privately initiates a deal by hiring advisory firms and considering potential bidders and ends when a preferred bidder is chosen after concluding certain activities (e.g., contacting potential bidders, disclosing non-public information under a confidential agreement, negotiating) (Boone & Mulherin, 2007; Dikova et al., 2010). For its part, the public takeover process generally begins with a public announcement and ends in resolution (completion or abandonment) after concluding certain activities (e.g., disclosing detailed and up-to-date information, conducting due diligence, negotiating) (Boone & Mulherin, 2007; Dikova et al., 2010). Whereas the target firm often negotiates with multiple potential acquiring firms during the private takeover phase (i.e., 1:M), it usually negotiates with only one potential acquiring firm during the public takeover phase (i.e., 1:1). Moreover, the target firm can more easily handle and affect deals during the private takeover phase than during the public takeover phase because it can choose the depth of the auction (e.g., the number of bidders, the information provided, the preferred bidder) (Boone & Mulherin, 2007; Hansen, 2001). Therefore, the bargaining power of the acquiring firm during the public takeover phase would naturally be higher than during the private takeover phase.

When an acquisition is abandoned after a public announcement, both the target and the acquirer are negatively affected (Asquith, 1983). Although abandonment at any phase in the process entails costs involving money, time and effort, abandonment during the public takeover process often generates much larger costs, including serious business and/or reputational costs over the long term (Luo, 2005; Officer, 2003). However, damage to the target firm is more severe than that to the acquiring firm because the former's management must continue to operate the firm, which it had intended to sell. For example, after the intention to relinquish firm ownership is revealed and then abandoned, the target is more likely to face threats to business continuity, such as reputational damage, abrupt customer churn, and employee agitation. Indeed, Asquith (1983) demonstrates that unsuccessful deals have a greater negative impact on the target than on the acquirer. One of our interviewees in the M&A advisory unit of a large investment bank compared such difficulties to those "a person rumored to consider leaving a firm faces when he has to give up the plan and stays". Moreover, target firms usually gain positive outcomes through acquisition, while acquiring firms often do not (Datta et al., 1992; King et al., 2004). Compared to acquiring firms, these differences will lead target firms to recognize higher opportunity costs and greater potential damage from deal abandonment.

Considering the greater bargaining power and lower potential damage of the acquiring firm, we assume that acquisition abandonment after a public announcement is more likely to be decided by the acquiring firm than by the target firm. Consequently, the current study endeavors to identify the determinants of the cross-border acquisition decision process mainly from the acquirer perspective. Indeed, the institutional system was created to prevent abandonment by acquiring firms to some extent and can serve as evidence of this assumption. For example, it is common in several countries for an acquiring firm to pay a portion of the total transaction amount as a down payment when selected as a preferred bidder before initiation of the public takeover phase.

2.2. Behavioral perspectives of risky decisions

As the ultimate decision regarding whether to complete a deal in our context is made by top managers, this study approaches the phenomenon from the perspectives adopted by managers with respect to risky decisions and risk taking (March & Shapira, 1987). A risky decision is defined as a decision involving "high uncertainty or extreme outcomes" (Sitkin & Weingart, 1995). Due to country—in addition to firm—differences, initiating and completing a cross-