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The effects of industry relatedness and takeover motives on cross-border acquisition completion☆

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ABSTRACT

This study builds on behavioral perspectives about risky decision-making and aims to identify the industry- and firm-level factors that affect decision makers' expected returns, perceived risk, and attitude toward risk. Together, these three criteria lead to the ultimate completion or abandonment of a cross-border acquisition after a public announcement. By using data from 1985–2008, this study presents empirical results from cross-border acquisitions. The results show that a cross-border acquisition deal is more likely to succeed when the degree of relatedness between an acquirer's and a target's businesses is high. The findings also show that acquisitions with strategic rather than financial motives are more likely to succeed.

1. Introduction

Accelerated globalization in the twenty-first century has motivated scholars to expand their interests to include cross-border mergers and acquisitions (M&As) (e.g. Di Giovanni, 2005, Very & Schweiger, 2001). However, most studies focus on completed deals because post-acquisition performance is the primary interest for scholars (Ahammad, Tarba, Liu, & Glaister, 2016; Asquith, 1983; Asquith & Kim, 1982; Dikova, Sahib, & van Witteloostuijn, 2010; Haleblian, Devers, McNamara, Carpenter, & Davison, 2009; Wong & O'Sullivan, 2001). The abandonment of an acquisition during the negotiation process, especially after a public announcement, is an important issue that may cause tangible or intangible damage to the firms involved (Luo, 2005). In this regard, the abandonment of a deal during a private takeover process, in which the parties discuss the deal behind closed doors, may simply cause some monetary and time losses. By contrast, abandonment after a public announcement to the market may result in more serious losses such as the exposure of corporate strategy, damage to reputation and credibility, and, in some cases, a large penalty (Officer, 2003). Given that the percentage of acquisitions abandoned after a public announcement is as high as 25% (Holl & Kyriaziz, 1996), the completion of an acquisition after a public announcement can be a significant indicator of a firm's ability to manage an acquisition (Muehlfeld, Sahib, & van Witteloostuijn, 2012). Consequently, this study's research boundary includes deals that firms complete or abandon after a public announcement; namely, this study excludes those acquisitions that firms complete entirely in private and those that firms abandon before a public announcement.

Given the spread of acquisition transactions worldwide, especially in the cross-border context (Bolger, 2014), this study proposes that many factors that underlie this phenomenon remain for scholars to explore. In order to provide a more comprehensive understanding of acquisition completion compared with abandonment, this study endeavors to contribute to the literature by examining the subject from the viewpoint of those decision makers who ultimately bring deals to a conclusion. The issue of whether or not to complete an acquisition deal represents a typically risky decision that individuals (corporate managers in this context) must make; thus, this study employs behavioral perspectives on risky decision-making that include prospect theory. While the traditional decision criteria consist of the positive factor of expected returns and the negative factor of perceived risk, behavioral perspectives on risky decisions also consider decision makers' attitudes toward risk, a criterion that the predictability of expected returns affects. Further, this study focuses on the industry- and firm-level factors—business relatedness and takeover motives respectively—that underlie the issue of acquisition completion compared with abandonment. The empirical results from 2495 transactions announced during 1985–2008 show that a combination of the relatedness between the industries of the engaged firms

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and the motives behind acquisition attempts elucidate the possibility of deal completion.

The structure of the rest of the study is as follows. The next section provides the theoretical background of the study and develops the hypotheses. Section 3 explains the analytical methods and Section 4 presents the results. Section 5 discusses the results and concludes with the implications of the findings and the proposal of a future research agenda.

2. Theory and hypotheses

2.1. Behavioral perspectives on acquisition decisions

Several decision steps apply to the acquisition process (Pablo, Sitkin, & Jemison, 1996; Very & Schweiger, 2001). Researchers (e.g. Boone & Mulherin, 2007, Moeller, Schlingemann, & Stulz, 2004, Schwert, 1996) often separate the takeover process into private and public takeover phases, with the former occurring before and the latter occurring after a public announcement. Usually, a target firm negotiates with multiple potential acquirers during a private takeover process (i.e., 1: many). However, a target firm typically negotiates with one potential acquirer during a public takeover process (i.e., 1:1). In addition, a target firm can manage and influence deals more easily during a private takeover process compared with a public takeover process (Boone & Mulherin, 2007). Hence, the bargaining power of an acquirer in a public takeover process is greater than in a private takeover process. Considering the increased bargaining power and relatively minor damage to an acquirer, this study assumes that an acquirer rather than a target is more likely to cause the abandonment of an acquisition after a public announcement. Consequently, this study endeavors to identify multi-level factors that underlie the decision process of cross-border M&A deals mainly from the acquirers' point of view.

Because senior managers make the ultimate decision to complete or abandon a deal in the context of this study, the approach taken here is to adopt the managers' perspective and consider risky decisions and risk taking (March & Shapira, 1987). The definition of a risky decision is a decision that involves “high uncertainty or extreme outcomes” (Sitkin & Weingart, 1995, p. 1575). In this regard, a cross-border M&A is a typical type of risky decision with potentially major consequences for the decision maker. Initiating and completing a cross-border M&A transaction often involves high levels of complexity and uncertainty due to differences in the institutional, economic, and cultural characteristics of firms' home countries and internal organizations (Hofstede, 1983; Shimizu, Hitt, Vaidyanath, & Pisano, 2004). In a risky decision situation, a decision maker selects a careful course of action based on an evaluation of expected returns and perceived risk. The level of expected returns positively affects the possibility of selecting the risky alternative, while the level of perceived risk negatively affects this possibility.

However, a decision maker undergoes serious difficulties when he or she anticipates a reasonable trade-off between expected returns and perceived risk (i.e., a situation in which high expected returns have high perceived risk or low expected returns have low perceived risk). With regard to problematic cases with a trade-off between expected returns and perceived risk, another theoretical dimension that affects a decision maker's evaluation of the situation is applicable; namely, attitude toward risk. Prospect theory (Kahneman & Tversky, 1979; March & Shapira, 1987) suggests that the predictability of expected returns can affect a decision maker's judgment because individuals tend to place more weight on certain outcomes than on uncertain outcomes. This phenomenon is the certainty effect. On the one hand, when the amount of expected returns is relatively certain, a decision maker tends to show a risk-averse tendency in order to avoid losing probable returns. Thus, the decision maker is likely to show sensitivity to any risk factor that harms the returns and to avoid the risky alternative (Kahneman & Tversky, 1979; Sitkin & Weingart, 1995). However, when the amount of expected returns is relatively uncertain, a decision maker tends to show a risk-seeking tendency in order to obtain the upside potential. Thus, the decision maker is likely to show insensitivity to any risk factor and to choose the risky alternative. Consequently, the predictability of expected returns, as a characteristic of a decision situation, affects decision makers' attitudes toward risk and then the possibility of taking the risky alternative.

2.2. The effect of industry relatedness

Extended research on diversification investigates related and unrelated M&As (e.g. Berger & Ofek, 1995, Capron, 1999). Although the studies present different results depending upon factors such as the data and the measurement method, most claim that related diversification produces more positive outcomes than unrelated diversification (Berger & Ofek, 1995; Rumelt, 1982). Because an acquisition leads to a combination of two parties (i.e., an acquirer and a target), the industry relatedness of the two parties also affects the acquisition. Thus, using logic that is similar to the reasoning behind diversification, the level of expected returns from a related acquisition is higher than the level from an unrelated acquisition, thereby increasing the chance of deal completion.

Moreover, the level of perceived risk is lower for a related M&A because an acquiring firm usually has a high level of knowledge and understanding as a result of low information asymmetry. An acquirer can gather critical information, grasp a target's potential in a limited time, and negotiate effectively by using existing knowledge and understanding, even in a cross-border context. These advantages are especially crucial when the relevant parties process an acquisition deal under time constraints and competitive pressures (Jemison & Sitkin, 1986). In addition, the tendency for an acquiring firm to pay a higher premium for a firm in a related business (Gondhalekar, Raymond Sant, & Ferris, 2004) expedites a target's acceptance of a deal's conditions (Wong & O'Sullivan, 2001).

To summarize, when a target's industry relates to that of an acquirer, the acquirer expects a high level of expected returns and has a low level of perceived risk. Thus, the likelihood of deal completion increases. Consequently, this study proposes the following hypothesis.

Hypothesis 1. After a public announcement, firms targeting related industries that engage in cross-border acquisitions are more likely to complete a deal than firms targeting unrelated industries.

2.3. The effect of takeover motives

Numerous studies demonstrate that the motives behind an acquisition affect the consequences in the post-acquisition phase (e.g. Berkovitch & Narayanan, 1993, Huyghebaert & Luypaert, 2010, Seth, Song, & Pettit, 2000). This study expands this line of research and argues that such motives also affect the likelihood of deal completion during the intermediate period between a public announcement and the final resolution.

Reviewing the studies on efficient motives, Angwin (2003a, b, 2007) categorizes an acquirer's motives into three types: financial, economic, and strategic. Financial motives relate to monetary synergy such as reducing capital costs or risk, improving external ratings and borrowing capacity, and generating cash returns in the short term. Economic motives relate to the expansion of a firm's size or its market share and enhance overall efficiency by realizing economies of scale or scope. Strategic motives, which are comprehensive and to some extent abstract, relate to increases in a firm's competitiveness as a result of changing an industrial structure and obtaining valuable assets. Despite this conceptual categorization into three types, differentiating between economic and strategic motives is often difficult. For example, an acquiring firm often regards the enhancement of economies of scale or scope as important strategic motives. In this context, Boateng, Qian, and Tianle (2008) view that Chinese firms' cross-border acquisitions for entering new markets for growth, diversifying into new industries, and acquiring