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The impact of firms' mergers and acquisitions on their performance in emerging economies

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ABSTRACT

This paper explores the relationship between mergers and acquisitions and firm performance by running a partial least squares regression with the data of listed Chinese pharmaceutical firms from 2008 to 2016. The results show that when other conditions are unchanged, value-chain-extension mergers and acquisitions and technology-seeking mergers and acquisitions are positively related to firm performance, and that the correlation between mixed mergers and acquisitions and firm performance is not significant. In addition, this study finds that firm growth ability, firm exclusive assets, firm size, and firm age positively impact firms' performance after their mergers and acquisitions, and that corporate governance, firm property right, and firm solvency have no impact on firm performance after mergers and acquisitions. Implications of the findings are discussed.

1. Introduction

Emerging economies refer to those countries that have low income level but rapid economic growth rate achieved by using economic liberalization as their primary engine of growth (Hoskisson et al., 2000; Xu and Meyer, 2013). In recent years, emerging economies make significant contributions to global GDP (Chen and Chen, 2016; Lebedev et al., 2015; Li, 2013, 2017; Padmanathan et al., 2018; Qiao and Yang, 2015; Sharma and Chanda, 2017; Wekerle et al., 2017). Emerging economies are able to boost their economic performance while many parts of the world economy, including developed economies, stagnated (Alves et al., 2016; Estorilio et al., 2017; Furtado et al., 2017; Nölke et al., 2015; Peng et al., 2016). According to World Economic Outlook Report (The International Monetary Fund, 2016), the growth rate in emerging economies in 2016 is 4.2%, whereas the growth rate in developed economies in 2016 is only 1.6%. This report predicts that emerging economies will make a larger contribution to the growth of world economy than developed economies.

Firms based in emerging economies have been undertaking mergers and acquisitions both inside and outside of their domestic markets (Meyer and Thaijongrak, 2013). Mergers and acquisitions strongly depend on the quality of financial markets, which are shaped by the institutional environment (Lebedev et al., 2015). Find that institutional changes, particularly corporate governance reforms, affect firms' decisions of mergers and acquisitions. In emerging economies, institutions and policies' changes are frequent, and industry concentration is low (Xu and Meyer, 2013). On one hand, firms in emerging economies have to make expansion for surviving in an environment full of fierce competition. Furthermore, they tend to choose mergers and acquisitions for achieving legitimacy (Yang and Hu, 2016). On the other hand, the improved institutions condition in emerging economies drive firms to perform mergers and acquisitions for better development (Cui, 2012).

Prior studies have explored how mergers and acquisitions impact acquirers' performance with inconsistent findings. Both negative acquirer performance (Aybar and Ficici, 2009; Bertrand and Betschinger, 2012) and positive acquirer performance (Bhagat et al., 2011; Bhaumik and Selarka, 2012; Chi et al., 2011; Gubbi et al., 2010; Nicholson and Salaber, 2013) have been found. For target firms, consistent positive returns on acquisitions have been found (Chari et al., 2012; Goddard et al., 2012; Liao and Williams, 2008).

The number of mergers and acquisitions performed by listed Chinese pharmaceutical firms are growing in recent years. Driven by new national policies, high investment return rate, and low industry concentration, listed Chinese pharmaceutical firms are looking for domestic small pharmaceutical firms, hospitals, chain pharmacies, foreign pharmaceutical firms, drug R&D institutions, and medical institutions as their targets of mergers and acquisitions. In addition, the new version of Good Manufacturing Practice (GMP), pharmaceutical circulation planning in China, the reform of drugs review and approval system, control of medical insurance, and the adjustments in medicine catalog

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are the factors that impact listed Chinese pharmaceutical firms' decision of mergers and acquisitions. Given the institutional changes in China and the rising number of mergers and acquisitions performed by listed Chinese pharmaceutical firms, this paper develops a behavior-performance framework for exploring the relationship between firms' strategies of mergers and acquisitions and their performance, specifically price-earnings ratio, by running a partial least squares regression with the data of listed Chinese pharmaceutical firms from 2008 to 2016. The results show that value-chain-extension mergers and acquisitions and technology-seeking mergers and acquisitions are positively related with firms' performance, whereas mixed mergers and acquisitions has no significant correlation with firms' performance. In addition, this study finds that firm growth ability, firm exclusive assets, firm size, and firm age positively impact firms' performance after their mergers and acquisitions, and that corporate governance, firm property right, and firm solvency have no impact on firm performance after mergers and acquisitions. The paper discusses the findings and provides implications for listed Chinese pharmaceutical firms to develop strategic plans regarding mergers and acquisitions.

2. Literature review

Formal institutions, together with informal institutions, act as the “rules of the game” in a society to promote economic exchange and coordination by creating order and reducing uncertainty (North, 1990; Williamson, 1985). Formal institutions provide an incentive structure within which “firms rationally pursue their interests and make choices” (Peng and Khoury, 2008:260). The country-level institutional factors define what is socially or legally appropriate in institutional settings (Scott, 2001) and condition firm strategies, practices, and their outcomes (Van Essen et al., 2012). The constraints and forces in the local environment converge and create isomorphisms, specifically coercive isomorphism, mimetic isomorphism, and normative isomorphism (DiMaggio and Powell, 2000). The institutional context is a key factor that influences firms' decisions and behaviors (Argyres and Liebeskind, 1999). Prior research has demonstrated the power of the country-level institutional environment in shaping how multinational enterprises choose an entry mode (Brouthers, 2002; Delios and Henisz, 2003), perform human resource management (Björkman et al., 2007), and select international joint venture partners (Roy and Oliver, 2009).

Institutions play a vital role in mergers and acquisitions undertaken between firms in developed economies and emerging economies as well as between firms in different emerging economies (Hoskisson et al., 2013; Luo and Tung, 2007; Meyer and Thaijongrak, 2013; Peng and Parente, 2012; Sun et al., 2015). As Lebedev et al. (2015) point out, significant differences exist in institutional environments, corporate governance practices, and markets between developed economies and emerging economies. Particularly, emerging economies have a greater degree of uncertainty, and lack transparency and contract enforcement (Lebedev et al., 2015). Stronger institutions are a driver of mergers and acquisitions undertaken in emerging economies (Meyer et al., 2009). In terms of the value created by mergers and acquisitions, Li and Qian (2013) argue that the higher level of institutional development provides better protection of shareholders' rights. Seth et al. (2002) find that mergers and acquisitions decrease shareholder value of the acquiring firms. In contrast, some studies find that target shareholders typically gain from the acquisition because of the premium paid by the acquirer (Datta et al., 1992; Hansen and Lott, 1996).

In recent years, the economic performance of mergers and acquisitions in emerging economies has attracted much attention from academia. Some scholars have examined the motivation of mergers and acquisitions. For example, from the perspective of corporate governance, Fu and Wang (2014) investigate the importance of self-motivation in firm management during mergers and acquisitions. Guided by behavioral finance theory, Brown and Sarma (2007) explore the relationship between overconfidence in firm management and firms' mergers and acquisitions. In China, because social transformation and fiscal decentralization are undergoing, studies of mergers and acquisitions mainly focus on government intervention (Fang, 2008; Pan et al., 2008; Zhang et al., 2013). In addition, the impact of asset exclusion and firm ownership on the performance of mergers and acquisitions is examined as well (Li and Wang, 2007; Zhao et al., 2014). In these studies, the motivation of mergers and acquisitions is attributed to one factor only. However, the decision of mergers and acquisitions is complex in firms. As Qiu et al. (2006) point out, when making decision of mergers and acquisitions, firms take into many factors account, including technical factors, scale economy in production or procurement, extending to the downstream & upstream industry value chain to reduce transaction costs, and entering into new markets.

Some scholars study the performance of mergers and acquisitions using diverse methods and different performance metrics standards. For instance, Feng and Wu (2001) study 201 mergers and acquisitions from 1995 to 1998 and find that the performance of listed firms rises right after the mergers and acquisitions and then drops. Jones et al. (2001) study 188 branch companies of multinational firms in the United States and examine their performance, including market competition performance, product innovation performance, and financial performance. They find that technological mergers and acquisitions has a negative impact on firm performance. The finding is confirmed by Qiu et al. (2006), who select data from the pharmaceutical industry. Fan and Yuan (2002) analyze the influence of mergers and acquisitions in the different stages of enterprises lifecycle on firm performance from the perspective of industrial evolution. They find that mergers and acquisitions can promote firm performance when a firm is at the growth stage. By analyzing the impact of intra-industry and cross-industry mergers and acquisitions performed by listed pharmaceutical firms on their performance, Yuan (2011) finds that the effects of different types of mergers and acquisitions on enterprise performance vary. Particularly, intra-industry mergers and acquisitions can improve firm performance, whereas cross-industry mergers and acquisitions has negative impact on firm performance. Moreover, other scholars apply data envelopment analysis to study the efficiency of mergers and acquisitions (Li et al., 2003).

However, findings in studies on the relationship between mergers and acquisitions and firm performance are not consistent. Although some scholars argue that the inconsistence might be caused by agency problems (Jensen, 1986; Wan and Guo, 2009), factors such as market mechanism, development status of capital market, and corporate governance structure should be considered. But these factors play different roles in emerging economies and developed economies. Given the institutional environment in emerging economies, when firms have proper strategies and clear target for mergers and acquisitions, they tend to integrate resources more quickly and more effectively after mergers and acquisitions. In this way, their mergers and acquisitions can be successful. Accordingly, we premise that firms' mergers and acquisitions in emerging economies will positively affect their performance.

3. Research design

3.1. Research model

Based on the existing literature, we develop the following model:

$$PER_i = \alpha_0 + \alpha_1 MA1_i + \alpha_2 MA2_i + \alpha_3 MA3_i + \sum \beta_i X_i + \mu_t + \varepsilon_i \quad (1)$$

where:

PER_i is performance of the ith firm
MA1 is value-chain-extension mergers and acquisitions
MA2 is technology-seeking mergers and acquisitions
MA3 is mixed mergers and acquisitions
X is a controlled variable

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