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How institutional differences moderate the experience efficiency relationship in cross border mergers and acquisitions

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Abstract

This paper aims to complement the research on how institutional determinants affect cross-border mergers and acquisitions. More specifically, the impact of differences on the extent of labour and shareholder rights protection on the short-term financial performance of the acquiring company is investigated. Furthermore, the influence of experience with previous acquisitions is examined. The research sample consists of 164 German companies that acquired 506 targets located in 45 different countries, including 255 German targets. Ordinary least square regressions are used to test the hypotheses. Findings suggest that the acquisition of targets in countries with lower labour protection standards positively influences the financial performance of the acquirer. Acquiring a foreign target with a different level of shareholder right protection is found to have a positive influence on the financial performance of the acquirer. In this respect, it is irrelevant whether the target is located in a country with lower or higher levels of shareholder right protection, as the findings suggest that cross-border mergers and acquisitions are appraised by the stock markets higher than in domestic acquisitions. Furthermore, previous acquisition experience, especially with cross-border deals, is found to positively influence the acquirers' financial performance.

Keywords:

Cross Border Mergers and Acquisitions, Institutional Differences, Organizational Learning, Acquisition Experience

1. Introduction

Through the acquisition of foreign firms, companies are trying to realise their globalisation strategy. At the same time, it is intended to utilise beneficial market opportunities (Johnson et al. 2012). However, research by Marks and Mirvis (2001) suggests that about three quarters of mergers and acquisitions do not fulfil post-merger financial and strategic performance objectives. According to King et al (2004), research has not identified a reliable antecedent which can be used to predict post-acquisition performance. Generally, academics agree that the current state of research on cross-border mergers and acquisition is fragmented (Shimizu et al. 2004; Erel et al. 2012). In this context, a broadly undiscovered research area lies at the interplay of acquisition experience and institutional factors on the acquirer's performance.

In accordance with the conceptual framework of North (1992), macro-environmental factors such as laws and the legal order of a country, influence the organizational learning process on a micro level. As a matter of fact, those macro-environmental characteristics vary across countries, and could therefore provide beneficial opportunities to the companies involved in a cross border transaction (Hopkins 1999). Previous research has determined several institutional factors, such as the extent of shareholder right protection and employee right protection, to have a significant impact on the overall acquisition performance (Erel et al. 2012; Capron / Guillén 2009).

If the acquiring company engages in several cross-border transactions, it is likely that the company can benefit from previous experience. Haleblian and Finkelstein (1999) found that the behavioural learning theory is most appropriate in the complex setting of cross border mergers and acquisitions. This theoretical framework states that previous and present macro-environmental factors of influence affect an individual's learning outcome (Haleblian / Finkelstein, 1999). This can be considered in line with the aforementioned concept of North (1992). Scholars such as Shimizu et al. (2004) argue that knowledge from previous acquisitions should positively moderate the overall post-merger performance. However, learning from such international transactions is considered to be very difficult, as every deal shows unique aspects and the number of external factors of influence is significantly high. Nevertheless, findings by Barkema and Schijven (2008) suggest that the scholars' acknowledgement of the positive connection between acquisition experience and the overall deal performance is mixed. Zollo and Singh (2004), for example, have not found a significant correlation between organizational learning from previous deals and the resulting post-acquisition performance. On the other hand, research by Haleblian and Finkelstein (1999) suggests that the effect of acquisition experience is U-shaped. It follows then, that inexperienced acquirers do not make generalization errors, yet highly experienced acquirers apply a best practice approach on upcoming transactions.

This paper aims to investigate the influence of external macro-environmental determinants on cross border mergers and acquisitions and the possible effect of acquisition experience. In that process, external factors such as the extent of shareholder and labour right protection standards are taken into consideration.

Based on the initial situation, this paper contributes to M&A research in two ways. First, important boundary conditions, namely labour and shareholder rights protection, are investigated. Second, acquisition experience is implemented as a moderating variable, assuming that all well experienced acquirers should be able to balance the threats of institutional differences. To test the proposed relationships, a quantitative research design based on secondary data was chosen.

2. Hypotheses Development

2.1 Effect of labour rights protection

Human Resource Management issues are considered to have a significant impact on the integration phase after cross-border mergers and acquisitions. Following such deals, the newly merged company tends to dismiss no longer needed workforce in order to establish a more cost efficient corporation (Aguilera / Jackson 2003). Unskilled and easy to replace workers are particularly likely to be affected by such downsizing strategies (Lehto / Böckerman 2008). In this respect, restrictive labour right protection standards could hinder an acquirer from realising a smooth process with company reorganization programs (Capron / Guillén 2009). Employee interests can furthermore be represented through labour unions, work councils or the chamber of labour. Such institutions are regarded as disposing of high bargaining power regarding human resource issues.

It would therefore be a reasonable conclusion that the acquisition of targets in countries with less restrictive labour protection rights shows a positive influence on the financial performance of the acquiring company, as reorganization strategies can be realized with fewer inconveniences. This leads to the following hypothesis:

> Hypothesis 1a: Acquiring a target in a country with less restrictive labour rights should have a positive influence on the financial performance of the acquiring company.

Companies which have gained relevant experience with the implementation and the reorganization of a target, typically have established thorough acquisition processes behind them. These are key for identifying and avoiding negative consequences, such as severance payments due to wrongful termination of employee contracts.

> Hypothesis 1b: Previous acquisition experience should positively influence the financial performance of the acquiring company.

2.2 Effect of shareholder right protection

According to Bris and Cabolis (2008), managerial skills in countries with strict investor protection rights are considered to be higher because inefficient managers can be dismissed more easily. Furthermore, in countries with lower investor protection standards, agency problems are more likely to occur resulting from the low ownership concentration (Bris / Cabolis 2008). This means that investors cannot adequately control their managers in order to fully represent their interests, paramount among them typically being an increase in profitability. Research by Capron and Guillén (2009) suggests that stronger protection of shareholder rights in the acquirer country, as opposed to the target country, enables the acquirer to more efficiently reorganise and restructure the target.

As a consequence, it would be reasonable to conclude that the reorganisation of a target with lower shareholder protection could lead to value creating effects. This leads to the following conclusion:

> Hypothesis 2a: Acquiring a company which operates in a less shareholder-protective country, should have beneficial consequences in relation to the acquirers' financial performance.

In line with the argumentation of the positive effects of organizational learning, experience with cross-border and domestic mergers and acquisitions should positively moderate the influence of institutional determinants on the extent of shareholder rights protection. An experienced acquirer can, for example, anticipate possible agency conflicts and as such, expedient actions can be taken in advance (Dikova et al. 2010).

> Hypothesis 2b: A more experienced acquirer should positively influence the financial performance of the acquiring company.

3. Data description

3.1. Sample description

The sample consists of mergers and acquisitions only and is restricted to only include acquirers that are listed on an established securities market. The target company could either be listed or unlisted. The observed timeframe includes deals which were completed between January 1st 2003 and December 31st 2013. The sample was further restricted to only include acquiring companies with their headquarters in Germany. The destination of the target was not restricted in order to guarantee the inclusion of domestic and cross-border deals. These criteria reduced the number of possible deals to 778. The sample was further restricted to only include deals where the acquirer made more than two acquisitions within the aforementioned timeframe. Finally, the sample was limited to only include deals within a five-year time frame prior to the latest transaction. As a result, the sample consists of 164 companies that acquired 506 targets located in 45 different countries.

3.2 Explanation of variables

3.2.1 Acquirer performance

In this analysis, the financial performance of the acquirer functions as the dependent variable. It is measured by the stock price of the outstanding shares of the acquiring company. The effect on the stock price is determined as the change of the share price before the deal announcement and one week after the deal completion. The advantage of applying such a short-term performance measurement is that other potential factors of influence which are not related to the transaction itself, are less likely to affect the performance of the acquiring company (Cording et al. 2010). Relevant data on the share price was retrieved from the ZEPHYR database from Bureau van Dijk.

3.2.2 Labour rights protection

The extent of labour rights protection is considered to be a significant institutional factor influencing cross-border mergers and acquisition. Sophisticated regulations in the target country could hinder the acquirer from efficiently reorganising the target and from laying off the no longer needed workforce (Capron / Guillén 2009). This paper uses the flexibility of wage determination, hiring and firing practices and the redundancy costs in weeks of salary as a proxy for assessing the extent of labour rights protection. The relevant data has been retrieved from the Global Competitiveness Report of the World Economic Forum.

3.2.3 Shareholder rights protection

In order to assess the extent of shareholder rights protection in a country, this paper uses the protection of minority shareholders' interests and the efficacy of corporate boards as proxies. The relevant data has also been retrieved from the Global Competitiveness Report of the World Economic Forum.

3.2.4 Relative Acquisition experience

Acquisition experience was measured by completed acquisitions within five years before the latest deal completion. Furthermore, acquisition experience was divided into experience with cross-border deals and experience with domestic deals, in order to gain insights on whether better results were made when the acquirer has experience with both approaches or whether experience with cross-border deals resulted in better performance of the acquiring company. The relative acquisition experience was computed in the following way:

$$\frac{\text{number of domestic deals}}{\text{number of cross} - \text{border deals}} \text{ x number of transactions}$$

4. Results

The impact of institutional factors on the efficiency relationship of cross-border mergers and acquisitions was assessed by applying Ordinary Least Square (OLS) regressions. The results are presented in Table 1. Model 1 shows the regression analysis of the control variables. Model 2 investigates the direct effects of differences within the extent of shareholder and labour right protection on the financial performance of the acquiring company. Models 3 and 4 evaluate the moderating effect of prior experience on the acquirers' financial performance. The relationship of domestic deals to cross-country deals and the relation of a targets industry are included as control variables. As indicated by Model 1, the relationship between domestic and non-domestic acquisitions has a beta value of -0,62+ implying that cross-border mergers and acquisitions are more appraised by the stock market than domestic deals. Furthermore, results on Model 1 suggest that acquisitions within the same industry are not extraordinarily rewarded by the stock market in comparison to the acquisition of companies from unrelated industries.

Short Term Performance	Model 1	Model 2	Model 3	Model 4
Labour rights		0,104$^+$	0,107*	0,135*
(Shareholder rights)²		0,059$^+$	0,086$^+$	0,066$^+$
Relative Experience		0,012	0,027	0,019
Interactions				
Relative_Experience_Labour rights				0,104*
Relative_Experience_Shareholder rights			0,074$^+$	
Controls				
Domestic_non_domestic	-0,62$^+$	-0,119*	-0,129*	0,081
Relatedness of industries	0,011	0,012	0,008	0,010
R^2	0,004	0,016	0,022	0,022

$^+$p<0.10, *<0.05

Table 1 Results on regression analysis

4.1 Results on differences in labour right protection

The findings of this paper suggest that lower standards in labour right protection in the target country, compared to the acquirer country, are of positive influence (β = 0,104$^+$) on the acquirer's financial performance. This finding implies that stock markets favour takeovers from companies located in countries with a lower level of labour right protection. The results further suggest that the acquisition of targets with equal or higher levels of labour rights protection standards are less appraised by the stock markets. Furthermore, investors tend to believe that value-creating measures such as restructuring and downsizing programs can be more feasibly conducted in such countries.

With respect to the moderating effect of acquisition experience, findings suggest that prior acquisition experience positively affects the aforementioned effect (β = 0,104*). Another finding worth mentioning, is that this positive effect is further increased, if the company in question has also gained relevant experience with cross-border mergers and acquisition, in comparison to domestic mergers and acquisitions.

These perceptions complement the results of Capron and Guillén (2009), with the finding that greater ability to reorganise and restructure a target due to lower legal protection of employees translates also into better financial performance. The positive moderating effect of prior experience with international deals can also be verified.

4.2 Results on differences in shareholder right protection

Results for the effect of shareholder rights protection show a U-shaped form. The beta value of $0{,}059^{+}$ suggests that a difference within the extent of shareholder rights protection has a positive influence on the financial performance of the acquiring company. Due to the U-shaped form, stock markets do not appraise the acquisition of targets in countries with lower shareholder protection to countries with higher levels of shareholder protection or vice versa. As a result, these findings imply that stock markets generally appraise cross-border mergers and acquisition over domestic acquisitions.

A possible explanation of the appreciation of cross-border mergers and acquisitions over domestic deals could be that a change of nationality occurs and therefore the laws of the acquiring country on shareholder rights protection are applied to the shareholders of the target company upon the deal completion (Bris / Cabolis 2008). As a result, identified negative effects of lower shareholder protection in the target country, such as agency conflicts or inefficient managers were eliminated during the integration process.

Experience gained from previous acquisitions is also found to have a positive influence ($\beta = 0{,}074^{*}$) on the overall financial performance of the acquiring company. Hence, companies boasting extensive M&A experience, further increase positive effects associated with country specific institutional differences. In this respect, previous experience with cross-border mergers and acquisitions is considered to be of more significance than experience with domestic deals.

Furthermore, it is noteworthy that 43% of the investigated transactions did not create value at all, if value creation is measured in terms of an increase in the stock price. Through the applied analysis, 2,2%
($R^2 = 0{,}022$) of the changes in the stock price of the acquiring company can be explained through differences in the extent of shareholder and labour right protection and the moderating effect of experience. For the investigation of influential factors on cross border mergers and acquisitions, such a low R^2 is still considered to show the significant effect of differences in institutional norms.

5. Conclusion

Findings show that acquirers who buy targets in countries with lower labour law protection standards seem to show a better financial performance regarding their stock price than companies that acquire targets in countries with sophisticated labour protection standards. This finding implies that the acquirer can restructure targets within lower labour protection standards more easily. Having said this, acquirers of targets in countries with rigid labour protection standards do not show a positive influence on the financial performance of the acquiring company.

Findings of this paper further suggest that a different level of shareholder right protection in the target country is to be of positive influence on the financial performance of the acquiring country. It is found to be irrelevant regardless of the extent of investor protection in the target country, as investors appraise cross-border mergers and acquisitions over domestic acquisitions.

Finally, previous experiences with mergers and acquisitions are found to have a positive influence on the overall outcome of the deal. As a result, acquirers should be more efficient and should avoid previously made mistakes. However, an internationally oriented company with global acquisition experience seems to prove more beneficial than companies where only domestic acquisitions were undertaken.

Additional research should take a more generalised approach on the acquiring country and should therefore include acquirers form several countries, including shareholder and stakeholder driven economies. Additionally, the number of investigated factors of influence should be increased. Another suggestion would be the measurement of the long-term effect on the financial performance of the acquiring company. Through such a long-term measurement, the effectiveness of the reorganization and implementation processes should be investigated. Finally, the effect of top management turnover should be included.

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