Risk Mitigation for Cross-Border Mergers and Acquisitions

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ABSTRACT

Cross-border mergers and acquisitions (M&As) have been studied extensively in accounting, finance, management, international business, and marketing. Decades of studies have investigated the cross-border acquisition behavior, including antecedents, moderators, and consequences in performance (Haleblian, Devers, McNamara, Carpenter, and Davison, 2009; Martyova and Renneboog, 2008). Cross-border acquisition, in practice, has also been recognized as the dominant vehicle for foreign direct investments (FDI) worldwide (Chari and Chang, 2009; Kengelbach, Keienburg, and Schmid, 2016). However, both past research and practices show that many M&A deals destroy value rather than create value for the acquirer (Haleblian et al., 2009; Seth, Song, and Pettit, 2002). Capital markets have long shown skepticism to companies’ M&A announcement.

Scholars have examined the M&A’s effect on market value creation and return generation. The determinants of value creation include business synergy, cultural proximity, and acquisition experience, which, however, are also found to be responsible for the value destruction. The mixed findings motive us to disentangle the positives and negatives by joint investigation. Furthermore, we focus on the risk-side of performance, which should be considered aligned with the return. Risk, is the chance of loss, or is the volatility of the return. In international business, country risk is inevitable for every Multinational Enterprises (MNEs). Country risk arises from the difference or unfamiliarity the MNE is faced with at the host country, including facets of institutional development, political stability, financial and economic market development, and cultural values.

Addressing the strategic international M&A risk is essential for companies’ growth and internationalization’s theoretical development. Our research question is “How to mitigate the country risk in cross-border acquisition context?” To answer our research question, we examine
U.S. acquirers’ international acquisitions during 2000—2015. We use Carhart Four-Factor Model to derive the deal’s systematic risk and unsystematic risk. Using the derived two risks as dependent variable, we jointly test both direct and indirect effects from country-level distance, deal-specific attributes, and acquirer-specific factors as independent variables. Thus, we can accurately get the risk level for each cross-border M&A deal, identify the explanatory factors for the risk, and propose the mitigation measures for country risk.

Our study has three main contributions. First, we address the gap in international business literature on the risk-side of performance. Literature has been mainly focused on the return-side of the performance. By using Carhart Four-Factor Model, we derive the risk change of cross-border acquisitions after the announcement. Then, we examine the determinants of the predicted risk (systematic and unsystematic risks). Second, uncontrollable risk (e.g., country risk) is more and more important to be quantified and mitigated through controllable factors. Besides examining the direct determinants of the uncontrollable risk, we also test the interaction effects between country-level distance factors, deal-specific attributes, and firm-specific attributes. Strategic international risk should be managed by simultaneously exploiting trade-offs among types of risks (Shrader, Oviatt, and McDougall, 2000). Third, we contribute on the theoretical implications for the link of diversification-risk. Literature has been argued that business diversification does not follow Modern Portfolio Theory (MPT). MPT suggest unrelated options decrease the risk for the firm while management theory argues that related business diversification minimizes the risk for the firm. By examining the industry effect in our study, we find both theories are applicable and plausible but in different industries. For financial and insurance industries, the logic of MPT—“put eggs into different baskets” is significantly tested. For manufacturing and service industries, the logic of management theory—“put eggs into similar baskets” is verified.
REFERENCES


