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How Can Experience Influence Cross-Border M&A Performance?

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Literature has offered positive or negative results of the relationship between performance, cultural distance and experience. This study considers the possibility that cross-border deal experiences can affect the success of the deal and the subsequent benefit from cultural differences. By relying on the event study methodology, we analyzed the stock market reaction of a sample of Italian firms in response to announcements of M&As, joint ventures, and minority stake purchases and found a positive and significant market reaction in response to the announcements. We found that cross-border deal experience positively affects performance. Cultural distance and the interaction between cultural distance and cross-border experience do not have significant results.

Field of Research: Cross-border M&A, cultural distance, experience, stock market performance

1. Introduction

For years, international deals between the developed countries dominated the deal market because the governments of many emerging countries had long imposed restrictions and barriers to inward and outward capital flows, limits on capacity extension, stringent licensing requirements to enter new businesses, et cetera, which inhibited the rise of deals between developed and emerging economies as a result of poor or absent growth avenues. In addition, until recently, technological innovation, transportation, and communication that advanced at astonishing rates only in the last few decades did not allow easy, fast, and cheap combination, integration, and communication between business firms located in geographically and culturally distant countries. The few deals involving developed and emerging economies were also initiated almost exclusively by developed-market buyers who acquired either minority or majority stakes in emerging-market targets.

There has recently been a steady transition in a number of emerging economies as governments tried to liberalize their closed economies. This has not only spurred both deals originated by developed-market acquirers largely through joint ventures and minority stake purchases, but also deals with developed-market firms by emerging-market companies.

Liberalization helps firms to go abroad but is not sufficient to overcome cultural differences. Numerous studies on cross-border deals show evidence of a negative implication for cultural distance (Björkman et al., 2007; Cartwright & Schoenberg, 2006; Schweiger & Goulet, 2000; Teerikangas & Very, 2006). Cultural distance, cultural incompatibility, and cultural misfit are viewed as a potential obstacle to exploiting synergistic benefits in post-merger integration processes (Barkema et al., 1996). In this sense, joint ventures are a useful alternative to M&A in volatile and uncertain markets. M&As become a subsequent

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choice when a firm is confident with the new market and has acquired sufficient information from its initial venture.

Additionally, other studies show that cultural distance provides new routines and repertoires that can increase their performance in new markets (Chakrabarti et al., 2009; Morosini et al., 1998).

Can a cross-border deal experience moderate the cultural distance? We consider the possibility that a cross-border deal experience can affect the success of the deal and the subsequent benefit from cultural differences. By relying on the event study methodology, we analyzed the stock market reaction of a sample of Italian firms in response to announcements of M&As, joint ventures, and minority stake purchases and found a positive and significant market reaction in response to announcements. We are also interested in exploring the determinants of value creation by OLS regressions; particularly, experience and cultural distance.

The remainder of the article is organized as follows. Section number two provides the conceptual background according to the principal statements set by both theoretical and empirical contributions in order to qualify the relationship between experience and cross-border M&A performance; section number three provides the data and methodology used to describe the variables that are supposed to affect the value creation of cross-border M&A; section number four discusses results and limitations of the study; section number five tries to draw some conclusions.

2. Literature Review

Cultural distance (Kogut & Singh, 1988; Shenkar, 2001), psychic distance (Johanson & Vahlne, 1977), and liability of foreignness (Zaheer, 1995) concepts suggest that the barriers, institutional gaps, costs, and risks associated with cross-cultural integration increase with growing cultural differences between individuals and companies.

Prevailing research in international business tends to emphasize the negative side of cultural distance (see Stahl & Tung 2015 for a complete literature review). The negative implications of cultural differences are corroborated by the poor performance of cross-border M&As (House et al., 2014) or the loss of effectiveness when cultural borders are crossed (Trompenaars & Hampden-Turner, 1997).

A cultural context includes investment risks associated with different host countries' economic, legal, political, and cultural systems, as well as market attractiveness. Cultural misunderstandings have led to numerous failures in cross-cultural mergers, acquisitions, and market penetration. As investment risks increase, firms tend to seek local knowledge through JVs with local firms. Firms entering markets characterized by a high investment risk may prefer JVs to reduce their exposure to these risks by reducing their resource commitment. Cultural context may also be a source of market potential as opposed to investment risk. Target countries characterized by high market potential tend to have a greater ability to absorb additional productive capacity, providing an opportunity to improve firm efficiency. Stagnant and shrinking markets make firms more reluctant to perform large investments such as those generally required by acquisitions. Second, in high growth markets, opportunity costs may be higher because of growth opportunities and opportunities for premium pricing. Firms should, therefore, opt for JVs when entering slow growth

markets. In other words, joint ventures can be considered a way to gain experience in a foreign country.

From another point of view, other existing theoretical perspectives in International Business theorize the positive aspects of cross-border deals. For example, Barkema and Vermeulen (1998) and Vermeulen and Barkema (2001) revealed that differences in cultures and systems help acquiring firms to overcome inertia, develop richer knowledge structures, and foster innovation and learning. Morosini, Shane, and Singh (1998) found that acquisitions in culturally distant countries are potentially more valuable because it is a mechanism for the acquiring (or the target) firm to access different routines and repertoires that are missing in its own national culture and which have the potential to enhance the combined firm's competitive advantage and performance over time.

Recent empirical research has concluded that cultural differences present a "double-edged sword" or "mixed blessing" in M&A (Reus & Lamont, 2009; Vaara et al., 2012). Performance may be positively or negatively associated with integration outcomes, depending on factors such as the magnitude of cultural change resulting from the merger, the integration approach chosen, and the use of social integration mechanisms.

In this sense, experience can positively affect performance because it can help acquirers to manage the uniqueness of cross-border acquisition (Markides & Ittner, 1994) to reduce integration costs (Slangen & Hennart, 2008) and rapidly benefit from the potential resource advantages of culturally distant acquisition targets (Zollo & Singh, 2004).

Dikova and Rao Sahib (2013) argue that cultural distance can be both "a bane and a boon" but the severity of the acquisition problems can be moderated by the experience. Acquisition problems are not the same for all firms engaging in cross-border acquisition deals. Firms involved in a large number of cross-border acquisitions may develop general routines on takeover processes, secure outside financial capital, legal aid or other resources (Hitt et al., 1998) and create special integration teams specialized in facilitating the acquisition process (Hébert et al., 2005) and benefit from the local market knowledge (Morosini et al., 1998).

Multinational firms, rather than small- and medium-sized firms, have the capabilities and the experience to reduce these conflicts by developing routines that are partly dependent on the national cultural environment in which firms operate. Following this line of argument, cross-border acquisitions can be interpreted as a mechanism for rapidly accessing attributes/resources embedded in other cultures without following a sequential path that leads to them. The two firms have the potential to enhance the combined firm's competitive advantage by interacting and learning the "way of doing things" from each other. Less experienced firms may need more time to handle the post-acquisition integration of a culturally distant target; hence, in the relatively short term, there may be fewer benefits from cultural diversity or heterogeneity (Dikova and Rao Sahib, 2013).

These arguments lead to the main hypothesis:

The higher the level of cross-border deal experience, the higher the impact of cultural distance is on cross-border deal performance.

3. Data and Methodology

The sample consists of 138 cross-border announcements which have the following characteristics: a) the deals include cross-border M&As, joint ventures, and minority stake purchases; b) acquirers are Italian-listed firms; c) sample firms are non-financial firms; and d) the deal is announced during the period 2005-2010.

M&A strategies consist of 99 events; JVs and minority stake purchases consist of 40 events. With reference to the country of destination, 103 events are related to internationalization strategies in developed countries, and 35 events involve internationalization in emerging countries.

Table 1: Main characteristics of the sample

Country of destination	Entry mode	Number of events
Europe	M&As	60
	JVs	12
North America	M&As	18
	JVs	4
South America	M&As	8
	JVs	4
Africa	M&As	4
	JVs	3
Asia	M&As	7
	JVs	15
Oceania	M&As	2
	JVs	1
Total		138

Information concerning internationalization announcements has been collected from *Bloomberg*; data related to stock returns and market indexes have been collected from *Datastream Thomson Financial*.

The analysis of the stock price reaction to the announcement of an event involving a firm's international expansion is carried out through two steps according to the event study methodology (Brown and Warner, 1985):

1) Estimation of abnormal returns in the period around the event announcement.
2) Analysis of the statistical significance of abnormal returns (Mikkelson and Partch, 1988; Boehmer et al., 1991).

The dependent variable is cross-border deal performance measured as the stock market reaction to the announcement of a cross-border deal. According to Brown and Warner (1985), we use daily returns and a 252 trading day window for estimation period starting at day -292 and ending at day -41. For the event period, we focus on several windows: (-5, +5), (-2, +2), (-1, +1), (-1, 0), (-2, +1).

The principal independent variable is cultural distance. We use the indices provided by Hofstede's approach. Cultural distance measure is calculated on the basis of the differences in country scores among all Hofstede's dimensions of national culture (Hofstede, 2001).

The other independent variable is the experience of the acquirer in completing acquisition deals. We use two measures of experience: cross-border deal experience and total deal experience. The cross-border deal experience is measured by the number of cross-border deals completed by the acquirer 5 years before the announced acquisition (Collins et al., 2008; Hayward, 2002). The total deal experience is measured by the sum of the cross-border and domestic deals completed by the acquirer 5 years before the announced acquisition.
In accordance with existing research, we include several control variables.

The first variable is the deal size of the acquisition. Larger deals are more likely to have an effect on stock market performance. Smaller deals may have low publicity and go un-noticed (Myers & Majluf, 1984).

The second control variable is the size of the acquirer measured by the number of employees. Moeller, Schlingemann, and Stulz (2004) find that larger acquirers tend to make poorer acquisitions than smaller acquirers in terms of stock market performance because managers' and shareholders' incentives are likely to be more aligned in smaller firms.

The third control variable is diversification based on 3-digit sic codes**.** Diversified firms can benefit from the so-called co-insurance effect in the sense that they may balance gains and losses of different business units leading to cash flow stabilization. They can further relax external financing constraints by creating an internal capital market (Stein, 1997). Another strand of literature focuses on inefficient internal capital markets and the increase of agency costs stemming from diversification (Shin & Stulz, 1998; Rajan et al., 2000).

To control for the incidence of country-specific determinants that may affect stock market returns, we analyze the governance quality, the volatility of exchange rate, the GDP growth rate and the GDP per capita. The governance quality of the host country is measured by using the indicator proposed by Djankov et al. (2008). They propose the so-called anti-self-dealing index that measures the protection of minority shareholders against expropriation by insiders. The index ranges from 0 (the lowest protection) to 1 (the highest protection). In countries with poor governance quality, international expansion may be influenced by several unknowns that could diminish performance and value of investments.

The volatility of the exchange rate is typically employed as a proxy for exchange rate risk. The higher the volatility of the exchange rate in the home countries of the acquiring and the target firms, the higher the uncertainty about the value of cash flows in the form of repatriated earnings to the parent company and, therefore, the lower the wealth gains to bidders and targets. This variable is expected to be inversely linked to wealth gains of both bidders and targets (Kiymaz, 2004).

Analyzing GDP per capita and GDP growth, empirical findings seem to be quite diversified without a clear and sound path. Grant (1987), by using accounting-based performance measures, finds that there is no significant difference in firm profitability related to the country of destination of FDIs; Doukas and Travlos (1988) find that international expansion via acquisitions results in higher abnormal returns when the country of destination is new and less developed than the US market; Pantzalis (2001) shows that firms with a presence

in developing markets perform significantly better than firms that only operate in advanced economies; Collins (1990), by relying on a number of risk-adjusted market measures, finds the performance of a sample of US firms engaged in FDIs in advanced economies to be better than that of firms being run in developing economies.

Finally, we include industry dummies and "ICE" dummy measured as the presence or non-presence of an Italian trade office (ICE) in the country where the deal is made.

4. Results and Discussion

The market reaction shows that investors are confident in the ability of Italian firms to increase their value through cross-border deals in the case of short event window (-2,+1) with a positive and significant ($p < 0.01$) abnormal return equal to 0.66%.

With reference to the main factors explaining the market reaction, the study shows that value creation is contingent on country-specific determinants. Table 1 presents a summary of correlations between determinants of cross-border acquisition performance.

Table 2: Bivariate correlations

	1	2	3	4	5	6	7	8	9	10	11	12	13	14
1 Performance	1.00													
2 Size	-0.08	1.00												
3 Deal Value	0.02	0.00	1.00											
4 Manufacturing dummy	0.10	-0.13	-0.20	1.00										
5 Service dummy	-0.10	0.05	0.00	-0.52	1.00									
6 Transp & pub utilities dummy	-0.04	0.11	0.23	-0.70	-0.24	1.00								
7 Diversification	-0.15	-0.04	0.12	0.02	-0.12	0.08	1.00							
8 Cross-border experience	0.12	-0.15	0.28	-0.15	-0.11	0.26	0.15	1.00						
9 Total experience	0.07	-0.16	0.27	-0.24	-0.04	0.31	0.18	0.87	1.00					
10 Cultural distance	-0.12	-0.06	0.08	-0.14	-0.04	0.20	0.12	0.12	0.09	1.00				
11 ICE	-0.03	0.03	-0.03	0.12	-0.01	-0.12	-0.13	-0.06	-0.07	-0.35	1.00			
12 Governance	-0.14	-0.01	-0.05	-0.07	-0.20	0.25	0.16	0.10	0.11	0.38	-0.14	1.00		
13 GDP per capita	-0.10	-0.05	-0.07	0.02	-0.20	0.14	0.11	0.09	0.07	0.38	-0.03	0.83	1.00	
14 Exchange volatility	-0.15	-0.08	-0.07	-0.06	-0.24	0.27	0.10	0.08	0.06	0.24	-0.14	0.71	0.54	1.00
15 GDP growth	0.05	0.09	0.08	0.05	0.26	-0.27	-0.15	-0.11	-0.13	-0.24	0.14	-0.87	-0.77	-0.81

Table 2 presents the results from the regression model. Model 1 is the model with cross-border deal experience and control variables. Model 2 adds total deal experience to analyze the effect of the domestic deals. Model 3 adds cultural distance. Model 4 excludes total deal experience and includes the interaction terms cultural distance*cross-border experience to understand if there is a positive effect of cultural distance on performance when acquirers are more experienced with cross-border acquisitions.

The study shows that there is a negative relation between performance and diversification. Firms that perform focusing strategies are better valued than firms carrying out diversification strategies. The result is consistent with past literature showing that firms engaged both in unrelated industrial diversification and in global diversification tend to have a larger value discount than their more focused peers. The increased agency costs linked to diversification exacerbate the risks of capital misallocation. The stock market seems to appreciate deals in related industries associated with a low country risk. This analysis is corroborated by the fact that GDP growth and exchange volatility have a negative and

significant ($p<0.05$) relationship with stock market returns. Cross-border deals create more value when performed in advanced economies than in emerging countries. Given that most announcements involve European target countries, our results seem to confirm the benefits of geographical proximity in the context of M&As.

Table 3 - Determinants of cross-border acquisition performance

	Model 1			Model 2			Model 3			Model 4		
			St Er									
const	0.0952	***	0.0299	0.1017	***	0.0306	0.1015	***	0.0307	0.0976	***	0.0306
Size	0.0000		0.0000	0.0000		0.0000	0.0000		0.0000	0.0000		0.0000
DealValue	0.0000		0.0000	0.0000		0.0000	0.0000		0.0000	0.0000		0.0000
Manufacturing dummy	0.0058		0.0080	0.0042		0.0082	0.0036		0.0083	0.0048		0.0082
Service dummy	-0.0081		0.0108	-0.0081		0.0108	-0.0084		0.0109	-0.0092		0.0110
Diversification	-0.0138	**	0.0064	-0.0132	**	0.0065	-0.0131	**	0.0065	-0.0137	**	0.0065
ICE	-0.0089		0.0110	-0.0087		0.0110	-0.0107		0.0119	-0.0109		0.0119
Governance	-0.0125		0.0079	-0.0124		0.0079	-0.0116		0.0081	-0.0124		0.0083
GDP per capita	-0.0043		0.0060	-0.0049		0.0060	-0.0041		0.0063	-0.0033		0.0063
Exchange volatility	-0.0273	**	0.0110	-0.0293	**	0.0112	-0.0285	**	0.0114	-0.0264	**	0.0112
GDP growth	-0.0151	***	0.0055	-0.0161	***	0.0056	-0.0153	**	0.0060	-0.0143	**	0.0059
Cross-border experience	0.0015	*	0.0009	0.0029	*	0.0017	0.0030	*	0.0017	0.0007		0.0019
Total experience				-0.0011		0.0011	-0.0011					
Cultural distance							-0.0001		0.0011	-0.0001		0.0002
Cross-border experience * cultural distance									0.0001	0.0000		0.0000
Observations	138			138			138			138		
R- squared	0.15			0.15			0.16			0.15		

* p<0.1; ** P<0.05; *** p<0.01

In literature, the empirical evidence shows mixed support for the role of cultural differences in international acquisitions. We argue that the effect of cultural distance is necessarily intertwined with international experience in explaining acquisition performance. The results confirm that there is no simple answer to the question whether acquirers will face negative or positive performance in distant cultures. There is no direct effect of cultural distance on acquisition performance. Cultural distance is not statistically significant in all models such as the interaction between cultural distance and cross-border experience. For this reason, our main hypothesis is not supported. To understand the nature of this result, it is important to underline the fact that the domestic experience does not seem to confer any benefits. The Hofstede's index measures the distance from one national culture to another and assumes uniformity within the national unit, but, in the Italian case, a firm's cultural variation explains as much if not more than intercultural variation. For this reason some cultural gaps are more disruptive than others and influence in a different way the international cooperation in terms of differential tolerances towards risk, formalization, and the like. In other words, Italian stock market appears to appreciate cross-border deal experience but at the same time does not consider culture the only determinant of distance with relevance to FDI. Country risk determinants appear to be preferred.

It is clear from our analysis that experience does play a role in explaining foreign market entry behavior of firms. Cross-border experience is positive and significant across all models (except Model 4). The results support the idea that uncertainty reduction is a prime driving force in market selection. Firms perceiving high degrees of uncertainty due to

inexperience are more likely to enter markets about which they have the best information. With increasing experience, however, they venture into progressively unfamiliar markets (Erramilli 1991).

5. Conclusion

The study investigates the possibility that cross-border deal experience affects the success of the deal and the subsequent benefit from cultural differences. The results show that the performance in cross-border M&As, joint ventures, and minority stake purchases are dependent on acquirer's level of acquisition experience. With increasing levels of cross-border acquisition experience, the likelihood of appropriate discrimination between international opportunities increases.

Important managerial implications are: a) experience with domestic acquisitions may not contribute in transferring knowledge to the cross-border context; b) cultural distance has no significant effect on the cross-border acquisition performance of experienced or inexperienced cross-border acquirers. The use of alternative measures, such as GLOBE "should be" or "as is", could improve the reliability of results. However, these results highlight the fact that the exclusive use of distance constructs has the potential to be both powerful forensic tools and a means of comparing options, but it perpetuates the role of cultural distance as a constraint and not an opportunity. These findings pave a way for future exploration of the Italian context to understand which cultural gaps are more disruptive than others and affect the stock market's performance.

Despite these interesting results, our study has several limitations. First, we capture only the short-term performance of cross-border deals. Particularly, M&A performance depends on several factors, such as integration process or consumers retention, that usually have an impact on long-term performance. Second, because of the limited size of the firms listed on the Italian stock market, our sample is small and the number of observations is limited. Future work will consist of enlarging the sample and the time period of the survey to at least 20 years.

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