The impact and differences between cross-border and domestic mergers and acquisitions on the market value of firms

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Abstract. Cross-border M&A has become the main mode of foreign direct investment for Chinese companies. The text uses the literature to briefly analyze the types of M&A, the different effects of different M&A types on the economy, and the effects and differences between cross-border and domestic M&A on the market value of companies, and to make policy recommendations that require attention to the integration of five aspects: strategy, organization and systems, finance, human resources and culture.

Keywords: domestic M&A; cross-border M&A; impact; differences; policies.

1. Introduction

According to the Statistical Bulletin of China's Outward Foreign Direct Investment (2015), cross-border M&A has become the main mode of outward foreign direct investment for Chinese enterprises; from only $3 billion in 2004, Chinese cross-border M&A rapidly increased to $54.44 billion in 2015, an increase of nearly 19 times in 12 years. However, while the rapid growth of cross-border M&A by Chinese companies is "encouraging", it also raises some doubts among the Chinese government, enterprises, and academics. Why do Chinese companies want cross-border M&A? Are cross-border M&As more beneficial than domestic M&As in creating market value? Compared with domestic M&As, Chinese companies may obtain more differentiated and high-quality resources through cross-border M&As, does this mean that cross-border M&As are more conducive to the enhancement of corporate market value? These questions may be debatable considering the resource integration, cultural and institutional differences, and the international management capabilities of Chinese firms after cross-border M&A. Therefore, the purpose of this paper is to examine the impact and differences between cross-border and domestic M&As of Chinese firms on the market value of firms.

2. Review of the literature

2.1 Study of types of mergers and acquisitions

Vertical Mergers, Horizontal Mergers, and Conglomerate Mergers are the classification of the types of mergers and acquisitions by The Federal Trade Commission (FTC), which in turn can be Diversification Mergers are divided into three types; Product Extension Mergers, Market Extension Mergers, and Pure Conglomerate. The concept and definition of M&A should burst into change with the continuous development of new technologies (Chan-Olmsted, 1998; Whalenand Litman, 1997).

Four types of M&As and their outcomes were studied by Chan-Olmsted in 1998 and their basic conclusions were drawn. The first type is horizontal M&A, which refers to the acquisition of firms in the same production stage, and the potential benefits of horizontal M&A are economies of scale and increased market power. The second type of M&A is vertical M&A, which involves companies that have upstream and downstream production relationships, mainly with suppliers and customers, and will have a significant effect on the control of product technology, access to important resources, and distribution channels, thus significantly increasing their economic efficiency. Moreover, vertical mergers and acquisitions often generate higher barriers to entry into the industry. The third type is Concentric Integration, in which the acquirer and the target company show some correlation in terms of the underlying technology, production processes, or markets. This type of acquisition occurs when a company expands its business lines or enters a new technology-related market. The fourth type is

Conglomerate Diversification, which includes pure diversification, product expansion, and market expansion. The main purpose of pure diversification is to provide stability and balance to companies that do not have any relevant resource-technology and product-market relationships. This type of M&A emphasizes the attractiveness of the target company (both in terms of profitability and market growth). One of the strategies of the BCG model is to move from low-growth, low-cash-flow markets into high-growth, high-profit-growth markets through M&A. The Boston Consulting Group's Product/Market-Portfolio Model is the most famous example of this approach. The former is the addition of complementary products to existing product lines, while the latter is the expansion of markets in different geographical locations.

2.2 A study of the economic consequences of different types of mergers and acquisitions

After horizontal M&As, firms can choose production technologies or organizational structures that can reduce unit costs, reallocate resources or share complementary resources, and thus improve their innovation and market coverage capabilities (Yehui et al., 2008). Based on resource-based theory, Li Shanmin et al. (2010) use data obtained from a survey of horizontal M&A events in the Chinese LPG industry and find that the higher the degree of M&A integration the more cost synergies can be demonstrated, resulting in lower costs, and the economies of scale brought about by M&A also allow firms to save on operating costs. Vertical M&A is the formation of integration in the upstream and downstream industrial chains to save costs by replacing market transactions with intra-organizational exchanges (Wang Wanqiu et al., 2016). Firms can control the key links of the industrial chain through vertical M&A and gain the maximum benefit from the institutional arrangement of division of labor (Yang Huixin et al., 2007). Horizontal M&A can generate scale effects and obtain synergies; vertical M&A saves transaction costs, and the improvement of performance after hybrid M&A is stronger than vertical M&A and horizontal M&A in the short term, but horizontal M&A is more advantageous in the long term and has a stable upward trend (Feng Genfu et al., 2001). Hybrid M&A is a way to diversify risks and seek average profitability across industries by implementing a hybrid strategy. Yang Wei et al. (2019) analyze a sample of 277 major asset restructurings in China from 2008-2014 and find that firms enter more profitable industries and transform their businesses through hybrid M&A due to the acquisition of more profitable assets. Ziva (2017) analyzes a sample of 394 listed companies in 13 countries and compares the impact of different M&A types in the industrial and service sectors and found that horizontal M&A leads to integration effects in the same industry sector, vertical M&A leads to integration effects in the service sector, and hybrid M&A leads to integration effects in both sectors, but neither has a significant positive impact on firms' profitability.

2.3 Positive impact of domestic versus cross-border M&A on market value

Domestic M&As enhance the market value of firms through three main mechanisms: first, the integration of resources between the two firms promotes "economies of scale" and "economies of scope" (Conn et al., 2005). Through mergers and acquisitions, the increase in firm size not only reduces production costs per unit of product but may also increase product variety, thereby increasing the market value of the firm (Conn et al., 2005). Second, complementary quality resources can integrate the quality elements of both firms, such as technology, R&D, branding, and management, to promote "synergy" (Moeller and Schlingemann, 2005). The complementary resources of both parties enhance the market competitiveness of the firm and thus increase its market value. Third, M&As allow firms to gain access to new industries or markets (Bradely et al., 1983). M&A enables firms to acquire the market entry channels, marketing networks, customer resources, and sales channels of the target firms. Compared to establishing market entry channels on their own, direct M&A may be less costly. This access to market entry channels not only increases a firm's market share but also has the potential to enhance market monopoly power.

Compared to ordinary domestic M&As, cross-border M&As not only have mechanisms such as "economies of scale" and "economies of scope", the complementarity of quality resources, and access to new market entry channels but also mechanisms to overcome market incompleteness and access to more heterogeneous and specific factors (Kohli and Mann, 2012). First, mechanisms to overcome market incompleteness. The ways to overcome market incompleteness include international diversification, firm internalization, and exchange rate theory. First, is international diversification. The incompleteness of financial markets across countries drives cross-border investment by firms due to market segmentation and incomplete factor mobility (Hymer, 1976). The incompleteness of financial markets leads to differences in the rate of return on capital across countries. Profit-maximizing multinationals diversify their asset allocation through cross-border mergers and acquisitions, increasing the market value of the firm (Kiymaz and Mukherjee, 2000). The second is the internalization of the firm. Morck and Yeung (1992) find that cross-border M&A with intra-firm asset transfers significantly increases market value. Third, is the exchange rate theory. Exchange rate theory suggests that the increase in the market value of cross-border mergers and acquisitions arises from exchange rate market frictions. According to this theory, if the target country's currency is relatively depreciated, it will lower its asset price, thus acquiring it at a lower price and increasing the market value of the acquiring firm. Andrade et al. (2001) found that the appreciation of the currency of the acquiring firm's country increased its market value.

The second is access to more heterogeneous elements. Compared to domestic M&As, firms can acquire more heterogeneous elements of advantage abroad, such as technology, R&D, brands, and marketing networks, from cross-border M&As. These elements may contribute to the market value enhancement of the firm (Moeller and Schlingemann, 2005). Since the above specific elements are not available or substitutable at home, firms engage in cross-border M&A to acquire more heterogeneous elements. Many scholars have argued that the market value of a firm's cross-border M&A may be a function of the specific factors acquired by the M&A (Kiymaz and Mukherjee, 2000). Thus the current study finds that cross-border M&A seeking specific factors significantly enhances the market value of firms (Kohli and Mann, 2012).

In summary, in terms of positive effects, there are mechanisms for both domestic and cross-border M&As, such as "economies of scale", "economies of scope", the complementarity of quality resources, and access to new market entry channels. However, cross-border M&As also have mechanisms to overcome market incompleteness and access to more heterogeneous and specific factors, so that additional mechanisms and channels exist to enhance market value. Whether this suggests that cross-border M&As create higher market value requires further analysis of the negative effects of domestic and cross-border M&As.

2.4 The negative impact of domestic versus cross-border M&A on market value

Cross-border M&As may also require higher M&A costs when obtaining more significant "synergies". On the other hand, as cross-border M&As involve differences in corporate cultures and systems, Chinese enterprises need to bear the "learning costs" and "institutional costs" of cross-border M&As. On the other hand, as cross-border M&As involve differences in corporate culture and systems, Chinese companies need to bear the "learning costs" and "institutional costs" of cross-border M&As. Therefore, compared with domestic M&A, M&A costs may be more "damaging" to the market value of cross-border M&A firms.

2.4.1 Compared to domestic M&A, cross-border M&A may incur higher "frictional costs", "synergy costs" and "operational costs"

First, increased information asymmetries between countries lead to higher "frictional costs". Information asymmetry leads to two problems: first, it increases the search costs of M&As. For example, M&A firms need to hire professional consultants to investigate issues such as the value of the target firm's assets, stock price, and finances. Second, it increases the bias in judging the quality and value of the target firm's assets. The lack of detailed information about the target firm's assets may lead to misjudgment of asset value, which allows inferior or low-value assets to be acquired (Brown and Sarma, 2007). Information asymmetry may also lead to M&A firms paying higher M&A premiums and choosing payment methods that are unfavorable to them, among others (Goergen and

Ren-neboog, 2004). Thus, search costs or misjudgment of the value of the target firm's assets due to information asymmetry can undermine the market value of the merging firm.

Second, cross-border M&As require higher "synergy costs". There are two reasons why cross-border M&As require higher synergy costs: first, both corporate and national cultural differences may increase the cost of post-merger integration. For example, knowledge and technology synergies, production reconfigurations, and personnel adjustments may increase synergy costs due to cultural differences (Bris and Cabolis, 2008). Second, communication and management costs are due to geographical distance. There are many inconveniences in coordination, communication, and management of both firms after cross-border M&A, which require firms to invest more costs for synergies, such as investment in information technology and equipment, time, and travel costs for personnel to travel across borders. Thus, higher synergy costs increase the operating costs of cross-border M&As and may undermine the firm's market value.

Thirdly, the host country system incurs higher "operating costs". First, the operating costs are mainly due to differences in employment, environmental protection, accounting, and financial systems. Not only do cross-border M&A firms have to comply with the host country's employment laws and environmental protection standards, but they also have to comply with its accounting and financial systems. Compared with domestic operations, these laws and systems may be different in terms of strictness and extensiveness, which increases the operating costs of the M&A firm. Second, is the host country's regulation in specific industries. The conversion of corporate ownership after a cross-border M&A may be restricted from entering certain industries and markets, and host countries have entry controls on foreign firms in certain industries and markets. For example, Chinese companies are usually not allowed to enter telecom operations, communication networks, and other strategic core industries in Europe and the US. Such industry and market entry controls may undermine the market value of the merging firm (Eckbo and Thorburn, 2000).

2.4.2 "Learning costs" and "institutional costs" incurred as a result of cross-border M&As in emerging markets and transition countries

These costs can hurt the market value of cross-border M&A firms in two ways.

First, developing countries need to incur "learning costs" in cross-border M&As. Hope et al. (2011) find that developing country firms often show "national pride" in cross-border M&As, especially for developed firms. This "national pride" is especially true for mergers and acquisitions of firms from developed countries. This "national pride" is reflected in the payment of excessive M&A premiums, cash payments, and "irrational" M&A. Excessive M&A premiums raise the cost of M&A and may lead to a "winner's curse" that destroys the market value of the firm. If cash payments are made, this may lead to a decline in cash flow and destroy the market value of the firm (Jensen, 1986). The "national pride" mentality may also lead to "pride and arrogance" behavior by managers of developing country firms. This irrational behavior not only triggers a "herding effect" that leads to excessive M&A but also leads to the acquisition of low-value assets that undermine the future market value of the firm (Auster and Sirower, 2002). Due to the negative effects of developing country M&A characteristics, current research finds that cross-border M&A by firms from emerging market countries has the potential to undermine market value (Aybar and Ficici, 2009).

Second, the characteristics of a transitional market economy require "institutional costs" to be borne. The most important feature of China's transition market economy is that state-owned enterprises occupy an important position in the economy, and the cross-border mergers and acquisitions of state-owned enterprises account for more than 80% of the total amount. The problem of unclear property rights and "principal-agent" is a persistent problem for Chinese SOEs. Due to the existence of the "principal-agent" problem, corporate managers have an incentive to expand their firms through M&As, a behavior known as "Empire Builders" (Hope and Thomas, 2008). Managers increase the size of their firms because the increase in size increases the resources and initiative available to the manager, which not only increases the manager's compensation, reputation, and power but also reduces the risk of dismissal (Jensen and Murphy, 1990). Existing research finds that the more severe the "principal-agent" problem and the weaker the firm's regulatory regime, the lower the cost for managers to act like "empire builders," thus providing an incentive for managers to expand at high costs, such as higher This incentivizes managers to expand their firms at high costs, such as acquiring other firms at higher M&A prices (Hope and Thomas, 2008). Due to the lower quality of the regulatory regime for firms in developing countries, existing studies find that managers of such firms have more incentives to expand their firms through M&As (Ball et al., 2003; Bushman et al., 2004). Thus, the "principal-agent" problem gives managers an incentive to expand their firms at a high cost through M&A. In addition, enabling cross-border M&As can bring other "large rewards" to them. For example, the increased size of the firm enhances its influence and thus the "political assets" of the leadership, and the "reputation" of the firm in terms of media coverage and public attention after the M&A event. This social "halo" and "reputation" may also motivate management to complete the M&A transaction. Thus, the negative impact of the "principal-agent" problem may undermine the market value of the firm.

The above analysis shows that compared to domestic M&As, Chinese firms can not only obtain "synergies" and overcome market incompleteness and acquire more heterogeneous elements, but also bear higher costs for cross-border M&As.

3. Policy Recommendations

Mergers and acquisitions may seem easy, but in the process of corporate integration there are multiple difficulties, and many companies are far from achieving the expected M&A results, or even worse than before the M&A, dragging down the whole company, shareholders, and stakeholders. It is important to know that when there is news of a merger or acquisition, the public will regard it as good news and will take a long position in the stock of the merging company. If the merger or acquisition fails to achieve the expected results or even causes the stock price to fall, the stakeholders will suffer huge losses. Therefore, post-merger integration is very important. This is because it requires effective integration of strategy, organization, finance, people, and culture, which are not only related to whether the strategic intent of the M&A can be fully implemented but also to whether the acquirer can effectively control the acquired party and whether the purpose of the M&A can be successfully achieved. Therefore, we need to pay attention to the following aspects of integration in the whole integration process.

3.1 Strategic integration

Both companies face the process of co-creation of their internal development strategies after the M&A event. If the development strategies of the two companies are synchronized, there are two ideas: First, the development strategy of the acquired company relies on the development strategy of the M&A company, so that the development strategy of the acquired party can be integrated with the development strategy of the acquirer step by step. The second is to retain the development strategy of the acquired company and expand the development strategy based on the original development strategy of the acquired company so that it is gradually consistent with the development strategy of the acquired company and becomes an important part of the development strategy of the acquired company. Third, according to the situation of each enterprise after the M&A, we will make a new development strategy for the enterprise from the actual situation. The advantage of doing so is to promote the coordinated development among the functional organizations within the post-merger enterprise, promote the optimization of the economic structure, and achieve the optimal allocation of resources and the maximization of benefits.

Strategic integration is the fundamental prerequisite for other integration after the M&A event, and its status is very important, and whether the corporate strategy can be realized becomes one of the key factors to measure the success or failure of the M&A. The M&A must be consistent with the long-term development strategy of the enterprise, and the purpose of the M&A must be to enhance the core competitiveness, only then will the M&A bring the proper benefits to the enterprise, and also bring more value to the shareholders and stakeholders. At the same time, the transfer of control and ownership of the enterprise by M&A is also the core determinant of whether the control can enhance the benefits, therefore, the ultimate benefits of M&A behavior are closely related to the strategic arrangement or strategic adjustment of the M&A party and the acquired party.

The core determinant of strategic integration is not only to obtain new core competencies but more importantly to solve the problem of compatibility between old and new core competencies. On the one hand, it is necessary to obtain new comparative advantages in new fields through M&A, and on the other hand, it is necessary to maintain and further strengthen the core competencies and give new elements and vitality to the merged company.

3.2 Organizational and institutional integration

The implementation of the strategy of any M&A company is based on the organization and system, so the integration of the organization and system is also a major concern in the M&A process. In this integration process, we often focus on the following two aspects.

First, the organization's vision and mission are redefined on a strategic basis. Only by redefining the vision and mission of the organization can the shareholders, employees, and managers of the company enhance their sense of responsibility and mission by taking a holistic approach to everything.

Second, restructuring the organization. The main purpose of this initiative is not only to reorganize the board of directors and adjust the management but also to include personnel deployment, process reengineering, departmental settings, functional adjustments, and job analysis. This is so that it can form a unified organizational system with mutual integration of inheritance and change, standardization and efficiency after the merger, and make its power system with a combination of openness and self-regulation, promote the scientific and reasonable management range and level after the integration, and make the responsibilities, powers, and interests of each division, strategic business unit, and functional department clearer.

3.3 Financial integration

Another integration required after M&A is financial integration. Financial integration means that the financial accounting system and accounting system of the acquired party are brought under the unified supervision and control of the acquirer, so that the acquired enterprise operates according to the acquirer's financial accounting and accounting system, intending to unify and effectively manage the various business activities of the overall enterprise after the M&A so that the M&A benefits can be maximized. In a sense, financial integration is necessary for the expansion of the enterprise, the basis for the financial synergy effect, and the guarantee for the completion of the strategic purpose. With the help of financial integration, the company can establish a complete set of financial systems for both the acquirer and the acquired party, and finally achieve the integration of corporate strategy and management, the sharing of corporate information, and the efficient use of corporate data. Financial integration of M&A companies involves all aspects of corporate finance, mainly including the following three elements: (1) financial goal-oriented integration; (2) integration of financial results and management system; (3) integration of accounting system and integration of performance evaluation system. When the financial integration is completed, a corresponding financial control department should also be set up to effectively supervise it. Without this department to assess and control the financial risks, the whole financial integration is impossible to succeed.

3.4 Human resources integration

The main purpose of human resources integration is to make the employees of the acquirer and the employees of the acquired company accept the M&A through various means and strive to understand each other, promote each other and complement each other, seek common ground while reserving differences, and work hard, while giving full play to their subjective initiative and working together for the common hope, to finally achieve the macro goal of common prosperity. In general, after a merger or acquisition, most of the employees of the acquired company will easily fall into a state of anxiety, with the pressure of life, work urgency, and anxiety about the future coming one after another.

If there is a large loss of core staff, the benefits of the acquisition will be much lower than when it was first planned, and the need for the acquisition will become questionable. Therefore, retaining the core staff, especially the core staff with core technology, is the top priority of human resource integration after M&A. "Thousands of troops are easy to get, one will be hard to find", imagine without Qian Xuesen, Deng Jiaxian and other core personnel, there will be no new China so brilliant two bombs and one-star business! Therefore, retaining these core personnel to ensure the benefits of mergers and acquisitions is the premise, but also the key to the success of the enterprise. Enterprises can take salary increases, shares, year-end dividends, and other effective and practical means to retain or stabilize the core talent within the enterprise. The competition of modern enterprises is essentially the competition of talents, and talents are the first development force and one of the decisive factors for the development of enterprises. In the M&A, facing the increasingly competitive talent market, how to stabilize the talents of both sides and how to prevent the huge salaries of other homogeneous enterprises from poaching is the primary problem to be solved by the M&A companies.

3.5 Cultural integration

Compared with the first four types of integration, cultural integration is more difficult. In the past 30 years, only 35% of M&As have been successful, and most of them have failed. In 85% of these failed mergers and acquisitions, CEOs cited different management styles and different company cultures as the main reasons for the failure. If a strong company acquires a weak and homogeneous company in an M&A, cultural integration is relatively easy; however, if the two companies are on nearly equal footing in the field, it may be difficult to effectively integrate the cultures. Corporate culture is an organization's unique cultural image consisting of its values, beliefs, rituals, symbols, ways of doing things, etc. Simply put, it is the various aspects of the company that are expressed in its daily operations. This culture is embedded in the history of the organization and cannot be directly changed overnight by rules and operating procedures. In a sense, the corporate culture can even determine the values and behaviors of the veteran workers who have worked in the company for many years. Therefore, to better complete the difficult historical task of corporate culture integration, we must not have the idea of "finishing it in one go", and we must not blindly implant the existing corporate culture of the acquiring company into the acquired company, as cultural integration can never be completed overnight. It is necessary for the acquiring company to take the essence and remove the dross, and to carry it out slowly in a transitional and step-by-step way to achieve certain results.

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