



Economic impact of political barriers to cross-border acquisitions: An empirical study of CNOOC's unsuccessful takeover of Unocal[☆]

Kam-Ming Wan^{a,*}, Ka-fu Wong^b

^a School of Management, University of Texas at Dallas, United States

^b School of Economics and Finance, University of Hong Kong, Hong Kong SAR, China

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ABSTRACT

In 2005, the US Congress challenged the acquisition by CNOOC (a Chinese state-owned enterprise) of Unocal (a US firm). This challenge creates a political barrier for foreign companies to acquire US oil companies. This paper examines the stock price reaction of US oil companies to this political opposition. Using an event study methodology, we find that this political barrier resulted in a substantial decline in the market value of US oil companies. For a period of 44 days, during which six anti-CNOOC-takeover political events occurred, the cumulative decline in the market value of a portfolio of 13 US oil refining firms was \$47.5 billion and that of a portfolio of 66 US oil and gas exploration firms was \$11.4 billion. This study is the first to analyze and quantify the stock price reaction of US non-merging firms to political barriers to cross-border acquisitions. It also has a policy implication regarding the recent enactment of the Foreign Investment and National Security Act of 2007.

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1. Introduction

Cross-border mergers and acquisitions (M&A) of US firms have garnered substantial momentum over the last two decades. According to the World Investment Report 2008 published by [The United Nations Conference on Trade and Development](#), the value of such activities had surged from \$49.8 billion in 1987 to \$379 billion in 2007. However, some recent attempts of foreign companies to acquire US firms have incited formidable political opposition. Notable examples include Dubai's Ports World's bid to manage five US ports in 2006 and CNOOC's offer to acquire Unocal in 2005.

Moreover, the US government's scrutiny of cross-border M&A has been tightened lately. Specifically, the Foreign Investment and National Security Act of 2007 (FINSA) was enacted by the US Congress and became effective on October 24, 2007. FINSA demands a more rigorous review on foreign investment in US companies, including cross-border M&A. The scrutiny is particularly heightened for investment in certain sensitive sectors, e.g., energy industry and industries involving critical infrastructure and technologies. Heightened scrutiny is also required for transactions involving an entity that is controlled by a foreign government.

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* Corresponding author.

E-mail addresses: kmwan@utdallas.edu (K.M. Wan), kafuwong@econ.hku.hk (K.F. Wong).

As a case in point, although France is a member of the North Atlantic Treaty Organization and should not pose military threats to the US, Alcatel's (a French telecom company) acquisition of Lucent (a US telecom company) in 2006 was approved only with an exceptional stipulation—the US government could rescind the transaction in the future, should the combined entity ever breach security commitments made to the US government ('A Higher Bar for Foreign Buyers', *Wall Street Journal*, January 5, 2007).

We contend that political opposition to cross-border M&A can impact negatively on the market value of domestic firms in two aspects. First, political barriers against foreign acquiring companies may lower the takeover probability, thus reducing the expected takeover premiums of domestic target firms. Extant studies (e.g., Eun et al., 1996; Harris and Ravenscraft, 1991) indicate that the share prices of target firms react favorably to announcements of cross-border M&A plans. Obviously, creating obstacles for foreign acquirers can shrink the pool of potential bidders for domestic target firms. Given an efficient capital market, the share prices of domestic firms may weaken, reflecting a lower probability of being cross-border M&A targets.

Second, such barriers may deny potential gains derived from cross-border M&A. Marr et al. (1993) have provided evidence suggesting that foreign bidders can enhance competition in the market for corporate control, while Eun et al. (1996) have shown that cross-border takeovers may generate synergistic benefits by virtue of an increase in the combined shareholder wealth of the acquirer and the acquired.

Hitherto, no research has examined and quantified the impact of political opposition to cross-border M&A on the economic value of domestic firms despite the importance of this issue. As such, this paper is groundbreaking with an event study of CNOOC's unsuccessful takeover of Unocal. We intend to contribute to the debate on cross-border takeover policy by providing the first quantitative study of the impact of a cross-border M&A attempt that is thwarted primarily by political opposition.

We choose to study the CNOOC case for three reasons. First, this case is deemed a milestone because the US Congress has set a precedent that may discourage future cross-border M&A in the oil industries and possibly other critical infrastructure industries. Consistent with this claim, it appears that FINSA is in part a response to the public outcry over CNOOC's attempted takeover of Unocal in 2005. Second, we choose the oil and gas industry because political barriers vary significantly across industries. Such barriers are particularly high in energy sector but low in sectors not involving critical infrastructure. LaRussa et al. (2008) indicate that the US Congress was particularly concerned with foreign investment in the energy sector. As a case in point, the US Congress did not oppose Haier (a Chinese stated-owned appliance-manufacturing company) from attempting to acquire Maytag (its US counterpart) during the same time when CNOOC attempted to acquire Unocal. Third, the rivalry between CNOOC and Chevron to woo the shareholders of Unocal was widely covered by the media and hence the events can readily be identified and chronicled.

To quantify the impact of the CNOOC case, we examine the share price reaction of numerous US oil companies to the events pertaining to a political challenge against CNOOC's proposal to acquire Unocal (hereinafter referred to as 'anti-CNOOC-takeover events'). Our sample firms comprise companies in the US oil refining and oil and gas exploration industries. Using an event study methodology, we discover that the share prices of these firms suffered a significant setback in the wake of six anti-CNOOC-takeover events. While an equal-weighted portfolio of 13 US oil refining companies (excluding Chevron) showed an average decline of nearly \$7.9 billion in its market value per event, another equal-weighted portfolio of 66 US oil and gas exploration companies (excluding Unocal) registered a decline of some \$1.9 billion on average per event. In sum, these two portfolios lost a total of nearly \$59 billion in their market values, which exceeded the gross domestic product of Kuwait in 2005!

The rest of this paper is organized as follows. In Section 2, we provide some background information about CNOOC, while a timeline of CNOOC's attempted takeover of Unocal and the associated political opposition are given in Section 3. Section 4 describes our sample and data, and Section 5 the methodology of our study. We discuss the empirical results and robustness tests in Sections 6 and 7, respectively. Our conclusion is set out in Section 8, with some remarks on future research directions.

2. Institutional details of CNOOC

The China National Offshore Oil Corporation Limited (referred to as 'CNOOC' throughout this paper) is an independent oil and gas exploration company operating primarily offshore from China and Indonesia. The company was incorporated in Hong Kong in 1999 and its shares are publicly traded on the New York Stock Exchange and the Hong Kong Stock Exchange. Nevertheless, CNOOC is often considered as a de facto Chinese state-owned enterprise because approximately 70% of its total outstanding shares are in the hands of the China National Offshore Oil Corporation, which is wholly owned by the People's Republic of China.

China's demand for energy has been growing rapidly due to its brisk economic growth. In 2003, China surpassed Japan to become the second largest consumer of petroleum in the world, behind the US. The International Energy Agency (2005) reported that the oil consumption of China increased by 15% in 2004, breaching 6 million barrels a day. However, China's domestic energy reserves are limited. Its oil and gas reserves account for about 1% of the world's total, compared with the US controlling roundly 2% and 3% of the world's oil and gas reserves, respectively ('Worldwide Look at Reserves and Production' *Oil and Gas Journal*, December 20, 2004). Coupled with a sustained increase in demand, such meager reserves have rendered China a net importer of oil since 1993, while the demand–supply imbalance is expected to worsen ahead. The International Energy Agency (2004) estimates that by 2030, the daily shortfalls in the oil and gas supply in China will amount to 11 million barrels and 47 billion cubic meters, respectively. Thus, it is understandable that Chinese oil companies are anxious to secure energy reserves worldwide.

Being one of the flagship oil companies in China, CNOOC has been actively acquiring energy assets in foreign countries such as Australia, Canada, Indonesia, Kazakhstan, Morocco, Myanmar and Nigeria (The major acquisitions made by CNOOC during 2002–2006 are set out in Appendix A). While these acquisitions are small in size, they indicate that CNOOC's interest in acquiring Unocal is in line with its expansion strategy.

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