International Business Review 19 (2010) 360–377

Contents lists available at ScienceDirect

International Business Review

journal homepage: www.elsevier.com/locate/ibusrev

Shareholders' reactions to announcements of acquisitions of private firms: Do target and bidder markets make a difference?

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ARTICLE INFO

Article history:
Received 5 June 2007
Received in revised form 2 February 2010
Accepted 4 February 2010

JEL classification:
F21
G14
G34
O57

Keywords:
Bidder market
Bidder returns
China
Cross-border acquisitions
Event study
Private firms
Target market
United States of America

ABSTRACT

We study announcement effects of cross-border acquisitions of private firms on short-term bidders' stock market returns in the European Union. We assume that the development status of the target market and the governance within the bidder market make a difference. Investors of bidding companies react positively to private acquisition announcements in both China and the United States of America (US). Moreover, the bidder returns do not differ significantly between the two target markets. We find bidder market effects for the US: private acquisitions by civil law firms generate smaller bidder returns, while relatively large private acquisitions by common law firms increase such returns. For China we do not find bidder market effects, nor variables that significantly explain shareholders' reactions to announcements of private acquisitions.

1. Introduction

In their study of acquirers from the United Kingdom Conn, Cosh, Guest, and Hughes (2005) find that private firms form the majority of firms acquired in cross-border acquisitions. They, moreover, show that acquisitions of private firms (in contrast to acquisitions of listed firms) generate positive announcement returns for the shareholders. In this study we extend the study of Conn et al. by studying whether the target market makes a difference for private cross-border acquisitions. For that reason we study acquisitions of private firms in two widely divergent target markets, namely China and the United States of America (US).

Prior research shows that acquisitions in emerging markets positively influence the short-term returns to bidders' shareholders (Chari, Ouimet, & Tesar, 2004). Although these authors do not include acquisitions of Chinese firms, it is likely that entering the Chinese economy will provide even better opportunities for acquirers, than entering other emerging markets. The Chinese economy is attractive because it has shown steady and rapid growth and because it is nowadays one of

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0969-5931/$ – see front matter
doi:10.1016/j.ibusrev.2010.02.002

the largest economies in the world. The Chinese economy has, moreover, only recently been opened for foreign acquirers.[1] Entering such a market may be very attractive for first movers.[2]

We have also broadened the scope of our analysis by studying acquisitions by European companies. This allows us to incorporate governance effects due to differences in the bidders' home markets, as the European Union includes countries with both common and civil law systems.[3] In particular, La Porta, López-de-Silanes, Shleifer, and Vishny (2000) find that cross-border acquisitions are most efficient if the acquirer is located in a common law country. Our choice of the European Union allows us to study if bidders from common law countries also outperform bidders from civil law countries where private acquisitions are involved.

This paper contributes to research on cross-border acquisitions because there is no previous research that focuses on the effects of cross-border acquisitions of private firms on bidder returns in different target markets. Moreover, there is no literature that assesses bidder returns of foreign acquisitions in China.[4] The study of differences between acquirers from common law and civil law countries in cross-border private acquisitions is also new and provides insights into whether investors value private acquisitions differently if the governance systems of the bidder markets differ. Finally, the research allows us to assess whether (or not) similar explanatory variables influence short-term investors' reactions in bidders' markets where cross-border acquisitions of privately owned firms in different target markets are involved.

We do indeed find positive short-term cumulative average announcement returns for announcements of acquisitions of private firms in China. We also find these returns to be positive for announcements of private acquisitions in the US and our hypothesis that the announcement returns for Chinese acquisitions will be larger than those in the US must be rejected. This suggests that previously documented relative disadvantages of acquiring in developed markets may not hold if one studies acquisitions of private firms. We do not find significantly higher shareholders' returns for bidders from common law countries in comparison to bidders from civil law countries. This may again be caused by the fact that we focus here on private acquisitions. For the explanatory variables, we find that relative deal size (+) and acquisition experience (−) influence short-term cumulative average abnormal returns of European acquirers in the US, but not in China. However, the bidder market matters for the explanatory variables, as the positive effect of the relative deal size in the US is generated by acquirers from common law countries, while the negative effect of acquisition experience is primarily caused by acquirers from civil law countries.

The further content of this paper is as follows. In Section 2, we present the literature on cross-border acquisitions and our hypotheses. Section 3 describes the dataset, the sample characteristics and our methodology. Section 4 sets out the empirical results, and Section 5 concludes the paper.

2. Literature review and hypotheses

2.1. Acquisition announcement effects

We assume that both the decision to internationalize and the choice of the market (China or the US respectively) have already been made for each cross-border acquisition.[5] Moreover, the chosen mode of entry is an acquisition. This implies that other forms of entry are outside our scope and that our sample is limited to those cases where acquisitions are likely to be the

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[1] At the end of the last century the Asian crises weakened Chinese companies and made the Chinese government more open to foreign investors, recognizing the skills and the capital they could bring. China's entry into the World Trade Organization (WTO) in December 2001 caused many of the entry barriers to disappear (Norton and Chao, 2001; Teng, 2004). Moreover, the Chinese government is experimenting with acquisition laws that are likely to follow international practice (Huang, 2001; Tan, 2003). Green (2003) indicates that the interest of foreign direct investors may also have increased as 100% ownership is now allowed in most industries. Cooke (2006), moreover, indicates that the eagerness of Chinese company managers to develop their company by getting access to outside capital, technology and management techniques also helps foreign investors to acquire companies in China. For a short summary of major developments in China, we also like to refer to an editorial in the International Business Review of 2008 (Fang, Zhao, & Worm, 2008).

[2] It is not surprising that these developments have made China one of the largest recipients of foreign direct investments in the world. http://stats.unctad.org/FDI/TableViewer/tableView.aspx?ReportId=3084.

[3] Originally, companies mainly from the United States and the United Kingdom participated in the acquisition market. The introduction of the Euro, access to deregulated financial markets, the privatization of companies and globalization have all encouraged continental European firms to become active participants in the acquisition market (Gugler et al., 2003; Martynova and Renneboog, 2006). For that reason, acquisitions by firms from the European Union are nowadays a logical choice if one wants to compare differences in cross-border acquisition announcement effects in different bidder markets.

[4] Information on bidder returns from foreign acquisitions in China has just begun to emerge, because, initially, foreign investment in China required the use of joint ventures or greenfield sites. Peng (2006) distinguishes three waves of foreign investments in China. First, in the 1980s, foreign direct investments took the form of joint ventures. Later, in the 1990s, many greenfield wholly foreign-owned enterprises were created. Nowadays there is a third wave of foreign direct investment that is based on cross-border acquisitions. It should be noted, however, that the vast majority of these foreign acquisitions concern private firms, because acquisitions of listed firms are still very difficult, even for Chinese acquirers (see Chi, Sun, & Young, 2009, who have only 19 listed firms in their database of 1148 acquisitions performed by Chinese acquirers).

[5] We refer to Dunning (1993) for an overview of the reasons why companies enter foreign markets and the potential benefits of international expansion. For internationalizing companies, the choice of which market to enter is generally based on the attractiveness of the market. Edwards and Buckley (1998) find that market size, income and concentration of the population are important, while cultural and psychic closeness of the target country are relevant for the first entry decision.