Journal of Corporate Finance 17 (2011) 1028–1046

Contents lists available at ScienceDirect

Journal of Corporate Finance

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

U.S. takeovers in foreign markets: Do they impact emerging and developed markets differently?

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ARTICLE INFO

Article history:
Received 19 November 2009
Received in revised form 4 May 2011
Accepted 6 May 2011
Available online 14 May 2011

JEL classification:
G14
G34

Keywords:
Cross-border merger and acquisitions
Contagion effects
Competitive effects
Rivals
Emerging markets

ABSTRACT

We investigate the effect that U.S. acquisitions of targets in emerging and developed countries have on the targets' rivals by measuring their stock price reaction to the acquisition announcement. On average, emerging market rivals react positively to these acquisitions while the reaction in developed markets is insignificant. In developed markets, the main factors explaining the reaction of rival firms are individual rival characteristics such as rival size, efficiency, growth opportunities, and leverage. In contrast, in emerging markets, country, industry, and acquisition characteristics such as economic development, shareholder protection, and the target's public status, industry, and percent acquired, play a more important role.

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1. Introduction

Many studies on cross-border mergers and acquisitions have examined their impact on both acquirers and targets, finding positive or no stock price effects for acquirers and positive effects for targets.[1] See, for instance, Bris and Cabolis (2008), Chari et al. (2010), Doukas and Travlos (1988), Harris and Ravenscraft (1991), Kuipers et al. (2009), Morck and Yeung (1992). However, the question of whether these takeovers benefit the targets' domestic markets is an important one that has largely been overlooked. This is particularly striking because a concern for both developed and emerging countries is the impact of foreign acquisitions on their markets. This is especially true for policy makers of recently liberalized countries as evidenced by their historical restrictions imposed on foreign acquisitions.

The objective of this paper is to study the impact of U.S. acquisitions on the target's industry rivals. We investigate whether emerging market rivals react differently to these acquisitions than developed market rivals. We expect cross-border takeovers to have a different impact on developed and emerging markets because these markets differ in their economic and legal environments, in addition to technology and skill. Further, we explore several factors that possibly explain cross-sectional differences of the effects of foreign acquisitions on individual rivals.

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[1] See, for instance, Bris and Cabolis (2008), Chari et al. (2010), Doukas and Travlos (1988), Harris and Ravenscraft (1991), Kuipers et al. (2009), Morck and Yeung (1992).

0929-1199/$ – see front matter. Published by Elsevier B.V.
doi:10.1016/j.jcorpfin.2011.05.001

We use two competing hypotheses to explain the reaction of the target's rivals. The contagion effect hypothesis predicts that the announcement of a cross-border acquisition will have positive effects for the target's local rivals as a result of the takeover conveying industry-wide, positive information. For instance, foreign acquisitions can benefit local markets through indirect technology transfers and inefficiency reductions (Görg and Greenaway, 2004). In addition, rival firms may also react positively if the acquisition signals an increase in the probability of future acquisitions (Song and Walkling, 2000). In contrast, the competitive effect hypothesis predicts negative effects for the local firms as they are unable to compete with the newly merged firm. We expect both contagion and competitive effects to be stronger in emerging countries than in developed countries because emerging economies are more likely to benefit from technology transfers and inefficiency reductions but are potentially at a greater disadvantage when having to compete with a firm from a more developed country. The question of whether rival firms in emerging and developed markets have an average positive or negative reaction is an empirical one and will depend on whether contagion effects or competitive effects are dominant.

We observe the stock price reaction of the target's industry rivals to 2125 cross-border acquisitions by U.S. acquirers, and study rival, industry, acquisition, and country characteristics that possibly explain their reaction to the acquisition. We focus on acquisitions by U.S. firms to hold constant the economic development of the acquirers' country and because the U.S. is involved in 40% to 50% of cross-border takeovers (Chari, et al., 2010; Erel et al., 2011). We include both public and private targets because private firms play an important role, particularly in emerging markets.

We find that the effect of foreign acquisitions on local markets depends on the difference between the economic development of the acquirer and the target's country. For developed markets, the average impact on rival firms is insignificant. Surprisingly, for emerging markets the acquisitions positively impact rivals consistent with contagion effects dominating competitive effects. This is in contrast to the common perception that firms in emerging markets will suffer from the entrance of a competitor from a developed country.

In developed markets, individual rival characteristics play a more important role in explaining the impact of the acquisition in the target market than country, acquisition, or industry characteristics. Abnormal returns are higher for rivals with low growth opportunities. This is consistent with previous research in the U.S. market which suggests that firms with low growth opportunities are more likely to be acquired (Hasbrouck, 1985; Mitchell and Mulherin, 1996; Song and Walkling, 2000). Higher leverage, a proxy for firm quality, has a mitigating effect on competitive effects. Smaller rivals have a more difficult time competing with the newly merged firm, consistent with the realization of competitive effects. Finally, rivals that are delisted after the acquisition experience higher returns, possibly because they become targets themselves. Of the industry, acquisition, and country attributes, only the relatedness of the acquisition matters—when the target and acquirer are in the same industry the newly merged firm has stronger competitive effects on rivals.

In contrast to rivals in developed markets, the characteristics of the acquisition itself, along with industry and country characteristics are more important in determining the impact of the acquisition on emerging market rivals. Specifically, rival returns are higher in countries with better shareholders' protection and in countries with lower GDP per capita. Firms in emerging markets with greater shareholder protection will be in a better position to grow and compete and, consequently, experience positive returns. Unlike the case among developed markets, the variation in GDP per capita in emerging markets is great enough that it is significant—those with less market development experience more contagion effects. We find that rivals of public targets and rivals of acquisitions in which a large percent of the target is acquired experience stronger competitive effects. We also find that rivals in technology-intensive industries benefit more, consistent with the takeovers providing benefits to rival firms through potential technology transfers. With respect to individual rival characteristics, efficiency is the only important factor—rivals that use their assets more efficiently experience more contagion effects.

Prior research provides limited evidence on the impact of cross-border acquisitions, despite the increase in their frequency. A few studies investigate the effects of all forms of FDI on the productivity of local markets in specific countries.[2] In general, studies of FDI in emerging countries document positive effects (for example, Blomström and Sjöholm, 1999; Kokko, 1994, 1996). However, some studies have also found mixed evidence or negative effects (Germidis, 1977). While these studies provide insight on the effects of FDI, they focus on one country, do not distinguish between forms of FDI (greenfield investment, M&A, and joint ventures), and use productivity measures—such as labor productivity, total factor productivity or ratio of imports to GDP. In particular, these measures of productivity suffer from endogeneity concerns in that a firm may choose to acquire in industries in which productivity is increasing. In contrast, the stock price reaction does not suffer from endogeneity concerns. Because the stock price is forward-looking, such information would have already been incorporated into the stock price at the time of the acquisition. Therefore, any change in price at the announcement of an acquisition will reflect only new information conveyed by the acquisition and its impact on future cash flows.

Most similar to this paper is the work of Bris et al. (2008) which examines the target's industry Q in the year after cross-border acquisitions, finding it is positively related to the percent of local firms acquired by foreign firms from countries with better investor protection. However, the industry Q measure reflects the valuation change of the target firms which may be a large fraction of the industry, particularly in emerging markets; thus the impact on rivals is not clear. Further, because the industry Q is measured one year after the acquisition, it is not clear if the acquisition is associated with value increases to local firms since the measurement of the effect is not immediate. In contrast, we examine individual competitor reactions at the time of the acquisition; this also allows us to examine the combination of competitive and contagion effects within an industry and the firm, industry, acquisition, and country characteristics associated with these reactions.

The rest of the paper is organized as follows: Section 2 discusses the contagion and competitive effects of cross-border takeovers. We describe the sample and methodology in Section 3. Section 4 presents results and Section 5 concludes.

[2] Görg and Greenaway (2004) provide an excellent summary of these studies.