Cross-Border Mergers And Acquisitions: Evidence From 10 Developed Countries

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ABSTRACT

This study attempts to explore the role of financial development on cross-border mergers and acquisitions (M&As) in 10 developed countries. Based on the sample period of 12 years (2000 – 2011), the data are analyzed by using dynamic panel data GMM estimator. Interestingly, we find that cross-border M&A respond positively and significantly to the stock market capitalization. The result highlights the importance of domestic financial conditions in stimulating an outward cross-border M&As during this period. Furthermore, the study also reveals evidence that market size (GDP) for host countries, trade inflation rate, exchange rate and Global economic crisis 2007/08 are statistically significant in influencing cross-border M&As from these 10 developed countries.

Key Words: Mergers and acquisitions; financial development; panel data; GMM estimator

1.0. INTRODUCTION

Foreign Direct Investment (FDI) whether come in the form of Greenfield investments or cross-border mergers and acquisitions (M&As) constitute a major form of financing for developed countries. Various reforms have been undertaken to improve the efficiency of financial markets on the continent.

We all know the primary role played by developed economies in the cross-border M&A activity. While Greenfield investments remain important, the increasing trend of cross-border M&As from developed countries are growing rapidly and changing the overall industrial landscape. The results of cross-border M&A have deepened

the economic integration of developed countries, and at the same time increase the competitiveness with the global economy.

Table 1 Cross-Border M&As, 2006-2011 (Billion US$)

	Purchases					
	2006	2007	2008	2009	2010	2011
World	625.3	1022.7	706.5	249.7	334.0	555.2
Developed Economies	497.3	841.7	568	160.8	223.7	428.1
Europe	300.4	569.0	359.0	102.7	41.9	168.4
North America	138.6	226.6	114.3	40.5	118.1	174.7
Other developed countries	58.4	46.1	94.7	17.6	63.6	85.0
Developing Economies	114.9	144.8	105.8	74.0	98.1	108.3
Asia	70.8	94.5	94.4	67.3	79.0	85.2
East Asia	21.2	-0.7	39.9	35.9	53.9	54.2
South Asia	6.7	29.1	13.5	0.3	26.7	6.1
Southeast Asia	7.5	25.9	18.9	4.3	13.7	18.2
Latin America and the Caribbean	28.1	40.2	2.5	3.7	15.8	18.8

Table 1 shows the value of cross-border M&As from 2006 to 2011. Developed countries accounted for 77% (US$428.1 billion) of world outward cross-border M&As (US$555.2 billion) in 2011. Amongst developed countries, countries from North America accounted the highest cross-border M&A purchases at 40.8%.

The increasing significance of macroeconomic factors in explaining the location of international production during the 1990s in the host country has been highlighted in most of literature (see Dunning, 2009 and Vasconcellos and Kish, 1998). In contrast, the relationship between outward cross-border M&As and home economy factors remain controversial and unclear. Thus, the aim of this study is to determine the role of financial development on cross-border M&As in 10 developed countries.

The present paper is organized as follow: section 2.0 provides the review of related literature. Section 3.0 outlines the data and methodology employed. Section 4.0 present results and discussions and section 5.0 concludes.

2.0. LITERATURE REVIEW

Relatively little works has been done in examining M&A flows at international level especially by using dynamic panel data GMM. As reported by Giovanni (2005), only two studies with such work, one by Pryor (2001) and the other by Vasconcellos and Kish (1998). By utilizing a large panel data set on cross border M&A, Giovanni stressed that institutional factors and financial variables are important drivers of M&As flows. His main result emphasized on financial market deepening in the acquisition countries as the main determinant of M&A. The study also reveals the importance of stock market in influencing an outward cross-border M&As.

Contrary to Giovanni (2005), Brooks and Jongwanich (2011) in investigating cross border M&A on 9 emerging countries from Asia found that banking sector (as compared to the equity and bond markets) plays an important role in influencing cross border M&A. Their result reveals that in Asia region, the main form of payments for the cross border M&A activity is still by cash. Thus, loans from the

banks and financial institution play the most important role as the mediator for the M&A deal.

On the other hand, Hyun and Kim (2010) in examining the role of institutions and financial development on cross-border M&As in 101 selected countries, reported that the stock market is positive and significant in all the three specifications, while credit by banks and other financial institutions is positive but insignificant in one instance. Therefore, their result is similar to Giovanni (2005) that stock market has greater impact on outward cross-border M&As.

Besides, Kamaly (2007) in investigating the determinants of cross-border M&As in developing countries found that S&P index in the U.S significantly explains cross-border M&A activity. He also emphasized that higher level of stock market activity and depth in developing countries decrease the amount of M&As.

Moreover, Uddin and Boetang (2010) in their study on the UK outward cross-border M&As (using home country macroeconomic factors) reveals that GDP, interest rate, exchange rate, share price and money supply are significant in influencing both outward and inward cross-border M&As.

Given the fact that there is a positive relationship between cross-border M&As and financial market indicators either from home or host countries perspectives, the present study attempts to examine the role of financial development on cross-border M&As in 10 selected developed countries.

3.0. METHODOLOGY
3.1. Data
This study is based on the panel data consisting of bilateral cross-border M&A, real GDP per capita (home and host countries), credit, stock market capitalization, trade, exchange rate and consumer price index from 10 developed countries (acquirers). Covering a sample period of 2000 through 2011, the data are obtained from Thomson One Reuter Database, World Development Indicators (WDI), Direction of Trade Statistics Yearbook (DOTSY), United Nation Conference and Trade Development (UNCTAD), International Financial Statistics Yearbook and CEPII database.

Note that in our sample of study, cross-border M&A less than 10% equity are excluded as by the definition, whereas these flows are included in the portfolio investment. The lists of the countries for this study are listed in Table 2.

**Table 2 List of Developed Countries Included in the
Cross-Border M&As Analysis**

Countries
Australia
Canada
Chile
France
Italy
Japan
New Zealand
Poland
Singapore
South Korea

3.2. Model Specifications

The model used in the analysis is a dynamic panel data specification in the form of:

$$(1)$$

i = 1, 2,…N ,t=2000,….,2011

Where:

: Total M&A to GDP ratio.

: The matrix of explanatory variables besides the lagged dependent variables.

: Country individual effect.

: Error term, which captures all other variables affecting .

and   are unknown parameters.

It is assumed that the error term, follows a one-way component model with constant variance, . The fixed-effects representation captures the idea of those countries, in most cases, which have individual effects such as geographical characteristics, institutional settings and cultural norms which influence the outward cross-border M&As but, can be regarded as fixed in short and medium terms.

The endogenous variable in this model are credit, stock, trade and exchange rate. We use the value of cross-border M&A transactions instead of number based on the assumption that a great deal of information is lost if one uses number of cross-border M&A deals. By using the value amount to weighing each observation according to its size, compared to the number of transactions itself. In addition, this is because of two reasons: first, to make sure the endogenous variable is stationary and second, to control for the size of target nation.

3.3. Estimation Procedures

This study employs three types of model in the panel data econometric analysis, namely; Pooled Ordinary Least Square (Pooled OLS) model, fixed/-random effects model and Generalized Method of Moments (GMM). The pooled OLS model and the fixed effect (FE) model are both estimated by using standard OLS method, while, the Random effect (RE) model is estimated by using Generalized Least Square (GLS) or Feasible Generalized Least Square (FGLS) method. For GMM, the estimates parameters are computed by minimizing the sum of squared differences between the population moments and the sample moments.

The problems with the pooled OLS are that this model does not take into account the heterogeneity of countries. In addition, once the lagged dependent variable is included in the specification, the model tends correlate with the fixed-effects in the error term, which then results in dynamic panel bias. The fixed effect model solves the heterogeneity problems of OLS by taking into consideration the individual specific factors of countries such as geographical characteristics, institutions and cultural norms which influence the outward cross-border M&As, and are fixed short to medium term. The presence of lagged dependent variable as an explanatory variable in the model increases the endogeneity problem, since the lagged dependent variable could be related to the error term. Resulting from this, a special type of panel data estimation is required.

One of the suggested solutions is for the dynamic panel bias problem to use Generalized Method of Moments (GMM) estimators. The Difference GMM, which was first, proposed by Holtz-Eakin et al. (1988) and further developed by Arellano and Bond (1991) transforms the model by using the first differencing of regressors to remove country-specific effects so that they are not related with the error term anymore. Given that our panel data is unbalanced, the Difference GMM might not be the ideal method alone, since it tends to have problems when dealing with missing observations and magnifying gaps in unbalanced panels.

Another alternative is to use the Arellano and Bover (1995) and Blundell and Bond (1998) system GMM procedure, where augment Arellano and Bond (1991) further assumes that first difference of instrument variable is uncorrelated with fixed effects (Roodman, 2006). This will results in more instruments that will improve efficiency of the estimators. However, one notable thing is, having too many instruments can be a problem especially when dealing with finite samples (Roodman, 2008). The instruments may seem valid individually, but not collectively, which will lead to result in questionable findings. Thus, this will lead to the issue of limitation of instruments, whereby one can select instrument with levels, or differences, or collapse the instruments.

Our estimation is then based on the following long-run model;

$$
\begin{aligned}
lnMA_{ij,t} = {} & \beta_0 + \beta_1 lnMA_{ij,t-1} + \beta_2 lnGDP_{j,t} + \beta_3 lnGDP_{i,t} + \beta_4 lnTrade_{ij,t} + \\
& \beta_5 lnTrade_{ij,t-1} + \beta_6 lnCredit_{j,t} + \beta_7 ln\left(\frac{Credit}{Y^N}\right)_{j,t-1} + \beta_8 Stock_{j,t} + \\
& \beta_9 \frac{Stock}{Y^N}\Big|_{j,t-1} + \beta_{10} lnCPI_{j,t} - \beta_{11} lnEX_{ij,t} - \beta_{12} lnDistance_{ij,t} + \\
& \beta_{13} DLang_{ij,t} + \beta_{14} DGEC_{ij,t} + v_{it} \\
& (2)
\end{aligned}
$$

Where the sub index i and j denote countries, t is for time and ln denotes natural logarithm (log).

$lnMA_{ij,t}$	= Log of real cross-border M&As flow from home economy j to host economy i.
$lnMA_{ij,t-1}$	= Log of lagged dependent variable for cross-border M&As.
$lnGDP_{j,t}$	= Log of market size of home economy, j (real GDP per capita).
$lnGDP_{i,t}$	= Log of market size of host economy,i(real GDP per capita).
$lnTrade_{ij,t}$	=Log of bilateral trade between home country, j and host country, i
$lnTrade_{ij,t-1}$	=Log of lag bilateral trade between home country, j and host country, i
$ln\left(\frac{Credit}{GDP}\right)_{j,t}$	=Log of credit provided by banks and other financial institutions relative to GDP in the home economy, j
$ln\left(\frac{Credit}{GDP}\right)_{j,t-1}$	= Log of lag credit provided by banks and other financial institutions relative to GDP in the home economy, j
$ln\left(\frac{Stock}{GDP}\right)_{j,t}$	= Log of market capitalization of equity market relative to GDP in home economy, j (percent)
$ln\left(\frac{Stock}{GDP}\right)_{j,t-1}$	= Log of lag market capitalization of equity market relative to GDP in home economy, j
$lnCPI_{j,t}$	= Log of inflation rate, CPI in home economy, j
$lnEX_{ij,t}$	= Log of nominal exchange rate between home economy, j and host economy, i
$lnDistance_{ij,t}$	= Log geographical distance between home economy, j and host economy, i
$DLang_{ij,t}$	= Dummy variable; to capture the language used, taking value of 1 if both home and host countries used the same official language; and 0 if otherwise.
$DGEC_{ij,t}$	= Dummy variable; to capture the effect of Global Economic crisis, taking the value 1 if observation in 2007 to 2008, and 0 if otherwise.

The expected signs for coefficients of explanatory variables are as follows:

$$\beta_1, \beta_2, \beta_3, \beta_4, \beta_5, \beta_6, \beta_7, \beta_8, \beta_9, \beta_{13}, \beta_{14} > 0;$$
$$\beta_{10}, \beta_{11}, \beta_{12} <$$

4.0. RESULT AND DISCUSSIONS
The results as shown in table 3 were estimated by using Pooled OLS, robust fixed effects, robust random effects, difference and system GMM.

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Table 3 Estimations of Determinants of Cross-Border M&As for 10 Developed Countries

Estimation Model	Dependent Variable : Log of Cross-Border M&As				
	POLS	FE Robust	RE Robust	DGMM2	SGMM2
L.logmaj	0.247***	-0.110*	0.194***	-0.339***	0.046
	(0.048)	(0.060)	(0.064)	(0.105)	(0.097)
lnGDPboone	0.915**	0.245	0.928*	0.563	1.901
	(0.430)	(4.153)	(0.484)	(5.942)	(1.265)
lnGDPpost	0.153*	1.298	0.150	7.062*	0.367*
	(0.082)	(1.429)	(0.092)	(3.780)	(0.184)
lnTrade	0.132	0.079	0.116	0.246*	-0.043
	(0.091)	(0.110)	(0.097)	(0.139)	(0.099)
L.lnTrade	0.058	0.054	0.079	0.160	0.170**
	(0.091)	(0.118)	(0.098)	(0.143)	(0.086)
lnCredit	-1.905**	-1.274	-1.861**	0.317	-1.635
	(0.845)	(1.082)	(0.780)	(1.713)	(1.356)
L.lnCredit	1.500*	1.301*	1.487*	0.026	1.175
	(0.834)	(1.015)	(0.761)	(1.749)	(1.215)
lnStock	0.628*	1.049***	0.594*	1.028*	0.945**
	(0.351)	(0.401)	(0.358)	(0.542)	(0.434)
L.lnStock	-0.735**	0.625	-0.705*	1.167*	-0.408
	(0.374)	(0.589)	(0.375)	(0.610)	(0.539)
lnCpi	1.180	3.390	1.244	-5.308	5.239***
	(1.363)	(4.052)	(1.169)	(6.362)	(2.136)
lnExchangerate	-0.113**	-1.366	-0.113**	2.576	-0.301**
	(0.054)	(0.959)	(0.065)	(2.312)	(0.122)
lnDistance	0.139		0.100		-0.101
	(0.102)		(0.120)		(0.395)
DLanguage	-0.067		-0.087		-0.222
	(0.255)		(0.267)		(0.668)
DGEC	0.626*	0.237	0.628*	0.463	0.636*
					(0.319)
	(0.279)	(0.296)	(0.273)	(0.332)	
Constant	-14.369*	-37.648	-14.449*		-44.579***
	(8.581)	(28.603)	(7.670)		(17.022)
Observations	515	515	515	316	515
R-squared	0.225	0.104			
Adj. R-squared	0.203	0.082			
Number of Id		151	151	77	151
No. of Instruments				155.000	192.000
AR1 p-value				0.040	0.000
					0.383
AR2 p-value				0.165	
Sargan p-value				0.062	0.036
Hansen p-value				1.000	1.000

Robust standard errors in parentheses
*** p<0.01, ** p<0.05, * p<0.10

The second column reports the pooled OLS (robust) model estimation. The third and fourth column presents the robust fixed-effect model and random effect model. Difference GMM and system GMM are in the fifth and sixth columns. In order to verify whether fixed-effects are preferred compare to the random effects, the Hausman specification test has been used. Based on the Hausman test, the calculated chi-squared value exceeds the critical value, we thus reject the null hypothesis and conclude that there is a correlation between individual effect and regressors.

In the pooled OLS (estimation 1), lagged dependent variable has a positive and significant effect at 1 per cent level. The finding is consistent with Visic and Peric (2011) and Kamaly (2007). This means that the previous year cross-border M&As is significant in predicting the current year activity. The positive relationship suggests the existence of sunk costs of M&A. Thus, firms need to incur large informational costs to find foreign partners, with previous experience which then helps save such costs.

Referring to the variable of interest, the first variable, Credit is statistically significant in influencing outward cross-border M&As from these developed countries but with negative effect. However, previous year credit seems to have a positive and significant effect on the cross-border M&As. The result is in line with Brooks and Jongwanich (2011). The second variable of financial development, Stock is positive and significant at 10 per cent level in encouraging an outward cross-border M&As from 10 developed countries. Previous year Stock is significant but has a negative effect on outward cross-border M&As.

For difference and system GMM, we use lag 2 and onwards as instruments. The lag restriction is important since it tells the underlying assumption about the length of effect of the endogenous independent variables on dependent variables. The chosen lag shows that it takes a minimum of two years for the financial development effect and trade on outward cross-border M&As. Given that our data is unbalanced panel data, the difference GMM might not be an ideal method since it tends to have problems when dealing with missing observations and magnifying gaps in unbalanced panels. According to previous researcher, most of them prefer System GMM. Thus, this also applies in our study.

Referring to the variable of interest, one sees that stock market capitalization is positive and significant in encouraging an outward cross-border M&As. In particular, 1% increase in the stock market capitalization (in the acquiring country) is associated with 0.945 % increase in the cross-border M&As activity. The result is in line with Giovanni (2005) and Hyun and Kim (2010) that reported a positive association between both indicators of domestic financial market depth and outward M&A. This suggests that banks and stock markets are complements rather than substitutes (Giovanni, 2005). The finding is not surprising since the country's financial system is at the early stages of the development (Agbloyor et al., 2012). Banks provide most of the finance that firm's need to grow and establish themselves. After these firm's are quite established, they can then consider a listing on stock exchange.

Based on the estimation, we found that market size of host country is positive and significant in explaining an outward cross-border M&As activity. A 1% increase in the market size (GDP of host country) is associated with 0.367% increase in the cross-border M&As activity. The findings of Hyun and Kim (2010) and Uddin and Boetang (2011) support the result.

The trade variable is statistically significant at 5 per cent level. 1 per cent increase in the trade intensity would increase the cross-border M&As by 0.170%. This suggests that cross-border M&As act as compliment for trade. The result is in line with Giovanni (2005), Kamaly (2007) and Hyun and Kim (2010).

Turning to the last macroeconomic variable, exchange rate, the variable is negatively significant at 5 per cent level. This result is in line with the previous findings, which predicts that exchange rate depreciation leads to an increase in FDI inflows into depreciating country. The negative sign is in line with Giovanni (2005), and Brooks and Jongwanich (2011) though they did not find any significance evidence on the exchange rate on cross-border M&As.

For the level of inflation, it was found to be positive and significant in explaining the outward cross-border M&As. The positive sign is not an unusual outcome since high inflation rate may sometimes be associated with rising level of economic

activities (Sayek, 2009). The result is similar with Ezeoha and Cattaneo (2011).

Lastly, the Global economic crisis 2007/08 is statistically significant in effecting cross-border M&As. This reveals that the 2007/08 Global economic crisis has increased the number of cross-border M&As in the selected developed countries. Further, for the serial correlation test; the test for first-order autocorrelation AR (1) rejects the null hypothesis that p-values are not serially correlated (see Table III). Nonetheless, the test for second-order autocorrelation AR (2) fails to reject the null hypothesis of no autocorrelation. Therefore, as expected, we do not find the presence of second-order serial correlation. Thus, AR (2) test support the validity of difference GMM and system GMM.

Moreover, the result for Hansen test of over-identifying restrictions indicates that the null hypothesis of exogenous instruments is not rejected with the p-value of 1.000. Nevertheless, the implausibly good p-value of this range of Hansen test should be interpreted with caution since the test is apparently weakened by too high instrument count.

5.0. CONCLUSIONS

This study uses dynamic panel data GMM in estimating the role of financial development on cross-border M&As in 10 selected developed countries for the period of 12 years (2000-2011). The findings reveal that stock market capitalization is statistically significant in influencing an outward cross-border M&As in the selected developed countries. The result is in line with the previous study (Giovanni, 2005; Kamaly, 2007; Hyun and Kim, 2010). Thus, an important conclusion can be drawn from our result that is the acquiring firms prefer to pay their acquisitions with stock particularly to minimize the valuation risk. The higher the price of acquirer's stock the more they tend to engage in cross-border M&As. This was supported by Sudarsanam and Sorwar (2010), who argued that acquisition with a share as a medium to transfer payment is one way to minimize valuation risk. The significant conclusion to be drawn here is that, the acquiring firms can minimize their costs and obtain financial synergies by paying attention to the stock markets as this should be a role for policy to support for the development of equity markets. The findings also revealed that the market size (GDP) for host countries, trade, inflation rate, exchange rate and Global economic crisis 2007/08 support an outward cross-border M&As. The contribution of this study offers future opportunity in several areas. For instance exploring the effects of cross-border M&As on banking sector development and stock market development would be one of the interesting study for future M&A theories.

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